Supreme Court, U.S.
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No. 03 . 937 DEC 29 2003

IN THE

Supreme Court of the United States

NEW ENGLAND HEALTH CARE EMPLOYEES PENSION FUND,
On Behalf of Itself and All Others Similarly Situated,
Petitioner,

v.

ERNST & YOUNG, LLP,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. What is the proper standard for triggering the statute of limitations on claims under § 10(b) of the Securities Exchange Act of 1934?

2. Under this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petrigrow v. Gilbertson*, 501 U.S. 350 (1991)—holding that claims under § 10(b) of the Securities Exchange Act of 1934 shall be governed by the text of the limitations and repose provisions in § 9(e) of the 1934 Act—is the one-year limitations period for § 10(b) claims triggered only by "discovery of the facts constituting a violation," as § 9(e) provides, or does it begin to run as § 13 of the Securities Act of 1933 provides for claims under §§ 11 and 12(a)(2) of the 1933 Act, either "after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence"?

PARTIES

The parties to this proceeding are the court-appointed lead plaintiff and petitioner, the New England Health Care Employees Pension Fund, on behalf of a class of all others similarly situated, and the defendant-respondent Ernst & Young L.L.P.

CORPORATE DISCLOSURE STATEMENT

The New England Health Care Employees Pension Fund has no parent corporation and is not itself a publicly traded corporation.

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RESTATEMENT (SECOND) OF TORTS

§ 552A 16

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NEW ENGLAND HEALTH CARE EMPLOYEES PENSION FUND,
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PETITION FOR A WRIT OF CERTIORARI

CITATIONS TO THE REPORTS

The decision of which review is sought is reported as *New England Health Care Employees Pension Fund v. Ernst & Young, LLP*, 336 F.3d 495 (6th Cir. 2003).

The denial of plaintiff's timely petition for rehearing is reported as *New England Health Care Employees Pension Fund v. Ernst & Young, LLP*, No. 01-6523, 2003 U.S. App. LEXIS 20070 (6th Cir. Sept. 29, 2003).

Although the district court's orders in this case are unreported, a related case is reported as *New England Health Care Employees Pension Fund v. Fruit of the Loom, Inc.*, Civ. No. 1:98-CV-99-M, 1999 U.S. Dist. LEXIS 12999 (W.D. Ky. Aug. 16, 1999).

BASIS FOR JURISDICTION

The Sixth Circuit entered its opinion and judgment on July 19, 2003. 1a-12a.

On September 29, 2003, the Sixth Circuit denied Petitioners' timely petition for rehearing. 13a.

This Court's jurisdiction, on a writ of certiorari, to review the judgment below is conferred by 28 U.S.C. § 1254(1).

RELEVANT STATUTES

A. Securities Act of 1933 § 13

As amended by the Securities Exchange Act of 1934, the Securities Act of 1933 § 13 provides:

> No action shall be maintained to enforce any liability created under section 11 or 12(a)(2) of this title unless brought within one year after the ***discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence,*** or, if the action is to enforce a liability created under section 12(a)(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 11 or 12(a)(1) of this title more than three years after the security was bona fide offered to the public, or under section 12(a)(2) of this title more than three years after the sale.

15 U.S.C. § 77m (emphasis added).

B. Securities Exchange Act of 1934 § 9(e)

Section 9(e) of the Securities Exchange Act of 1934 provides in relevant part:

> **(e) Persons liable; suits at law or in equity**. . . . No action shall be maintained to enforce any liability created under this section, unless brought within one

> year after the ***discovery of the facts constituting the violation*** and within three years after such violation.

15 U.S.C. § 78i(e) (emphasis added).

C. Securities Exchange Act of 1934 § 18(c)

Section 18(c) of the Securities Exchange Act of 1934 provides in relevant part:

> (c) **Period of limitations.** No action shall be maintained to enforce any liability created under this section unless brought within one year after the ***discovery of the facts constituting the cause of action*** and within three years after such cause of action accrued.

15 U.S.C. § 78r(c) (emphasis added).

STATEMENT OF THE CASE

A. Jurisdiction Below

Because this case involves securities-fraud claims filed by the New England Health Care Employees Pension Fund (the "Pension Fund") under § 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), the district court had jurisdiction under 28 U.S.C. § 1331 and 15 U.S.C. § 78aa. The Sixth Circuit exercised jurisdiction under 28 U.S.C. § 1291.

B. Proceedings Below

The case involves false financial statements filed with the Securities and Exchange Commission ("SEC") by Fruit of the Loom, Inc. ("Fruit"), an issuer of publicly traded securities. A purchaser of those securities, the Pension Fund alleged, in a related action filed on July 7, 1998, that Fruit's financial statements failed to comply with Generally Accepted Accounting Principles ("GAAP") and that Fruit and its top officers had committed fraud by falsifying the company's financial results for its 1996 fiscal year, and for the first two

quarters of fiscal 1997. "Promulgated by the accounting profession's Financial Accounting Standards Board, 'generally accepted accounting principles' are the conventions, rules and procedures that define accepted accounting practices." *United States v. Arthur Young & Co.*, 465 U.S. 805, 811 n.7 (1984).

The Pension Fund knew from the outset that Fruit's financial statements did not comply with GAAP, and that Ernst & Young ("Ernst") had both audited Fruit's 1996 financials and certified their compliance with GAAP. Fruit's SEC filings said as much. But just because the Pension Fund had sued Fruit for falsifying its financial statements did not mean that it had the facts needed to proceed against Fruit's independent auditor for consenting to use of a clean audit opinion in Fruit's 1997 securities offerings.

This Court holds that fraudulent intent, or "scienter," is an element of any violation of § 10(b). *See Aaron v. SEC*, 446 U.S. 680, 689-91 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976). Thus, unless Ernst acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud," it committed no violation of § 10(b). *Hochfelder*, 425 U.S. at 193 & n.12. In *Hochfelder* itself, this Court held that an auditor had not violated § 10(b) by acting negligently, *see id.* at 215, and many subsequent decisions have applied the precedent to hold that auditors are not responsible for a client's financial fraud absent facts demonstrating the auditors' scienter—which cannot be presumed. *See, e.g., In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 627-28 (9th Cir. 1995); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1425-27 (9th Cir. 1994); *DiLeo v. Ernst & Young*, 901 F.2d 624, 629-30 (7th Cir. 1990).

Nor could the Pension Fund file suit against Ernst hoping to develop the facts later—invoking general notice-pleading principles, perhaps, and Federal Rule of Civil Procedure 9(b)'s proviso that "intent, knowledge, and other condition of

mind of a person may be averred generally." Fed. R. Civ. P. 9(b). For with the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. Law 104-67, § 101, 109 Stat. 743, 758 (1995), Congress enacted a new § 21D(b) of the Securities Exchange Act of 1934, which abrogates simple notice pleading principles for private securities actions—and even Rule 9(b)'s proviso that condition may be generally averred. An investor's complaint "shall, with respect to each act or omission alleged to violate [the 1934 Act], state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2).

Designed to discourage baseless lawsuits, 1934 Act § 21D(b)(2) thus required the Pension Fund to have facts raising a strong inference of Ernst's fraudulent intent or scienter *before* filing a complaint. 15 U.S.C. § 78u-4(b)(2); *see Helwig v. Vencor, Inc.*, 251 F.3d 540, 548-52 (6th Cir. 2001) (en banc); *In re Comshare Inc. Sec. Litig.*, 183 F.3d 542, 551-54 (6th Cir. 1999). Applying it with vigor, courts regularly dismiss claims against auditors on the ground that facts showing even gross negligence are not enough to proceed—investors must present evidence raising a strong inference of auditor scienter even *to plead* a claim. *See, e.g., Comshare*, 183 F.3d at 548; *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 387-91 (9th Cir. 2002); *Rothman v. Gregor*, 220 F.3d 81, 98-99 (2d Cir. 2000); *In re Livent, Inc. Sec. Litig.*, 78 F. Supp. 2d 194, 217 (S.D.N.Y. 1999).

Thus, although the Pension Fund knew from the outset that Ernst had audited Fruit's inaccurate 1996 results and consented to use of the false audit opinion to raise money from investors in Fruit's 1997 securities offerings, the Pension Fund needed more than that before it had a § 10(b) claim to plead. It needed particularized facts raising a "strong inference" that Ernst had acted with scienter. Developing those facts was no easy task. Ernst was not about to fess up

voluntarily. Discovery in the Pension Fund's case against Fruit was stalled for more than a year by 1934 Act § 21D(b)(3)(B)'s provision that in private securities actions "all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss," 15 U.S.C. § 78u-4(b)(3)(B), and again by a bankruptcy stay when, shortly after the district court denied its motion to dismiss the case, Fruit filed bankruptcy.[1] Even when discovery began, obstructive discovery responses required the Pension Fund to move to compel.

Eventually, and less than a year before filing action against Ernst, the Pension Fund learned further facts from workpapers produced in discovery—implicating Ernst in its client's fraud. Audit workpapers provided the evidence that Ernst knew Fruit had very poor controls over inventory. R28 Complaint: ¶ 89, pgs. 37-38, Apx. 124-25. They showed that Ernst knew that Fruit had suffered "physical losses" of inventory, and that it was missing some $15.6 million in inventory at December 30, 1996, which the company could not explain. Audit workpapers further showed that Ernst was provided with reports detailing the investigation of serious irregularities (intentional misstatements) at Fruit's denim unit that Fruit's internal controls had not disclosed. *Id.* Other audit workpapers showed that Ernst was alerted to further red flags, indicating a danger that Fruit's reserves were inadequate. Audit workpapers showed Ernst knew that Fruit had reduced its total reserves for inventories at December 30,

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[1] The Pension Fund filed its suit against Fruit on July 1, 1998, but the defendants filed motions to dismiss, triggering a § 21D(b)(3)(B) automatic stay, 15 U.S.C. § 78u-4(b)(3)(B), until the district court denied the defendant's motion to dismiss on August 18, 1999. *See* 46a-64a. The Pension Fund commenced discovery, only to find its case subject to a further automatic stay, under 11 U.S.C. § 362, when Fruit filed bankruptcy on December 29, 1999. *See In re Fruit of the Loom, Inc.*, No. 99-4497 (D. Del. Bankr.) (filed Dec. 29, 1999).

1996, by 46% from the year before, even though total inventories had been reduced only 15%, *id.*, and that the "general" unallocated reserves for inventory were decreased from $4 million to $1.5 million. *Id.* Audit workpapers also showed that Ernst knew Fruit's 1996 revenues were based on "sales" to resellers, in which Fruit had granted extended payment terms and other benefits, to induce the resellers to accept excessive amounts of product, and that Fruit was recognizing revenue upon shipment despite contingencies that, under GAAP, precluded recognition of that revenue. *Id.*

The Pension Fund also learned that the auditors continued to work closely with Fruit, performing extensive work in connection with Fruit's unaudited 1997 quarterly financial statements, and that in the course of this work, Ernst learned of additional facts indicating that Fruit's accounting was improper. Summary-review memoranda that Ernst prepared in 1997, for example, demonstrated Ernst's knowledge that Fruit took inadequate reserves. R28 Complaint: ¶ 97, pgs. 40-41, Apx. 127-28. Ernst wrote that "'[w]e continue to believe that reserves for excess, close out and discontinued styles are understated . . . .'" *Id.* Ernst noted that Fruit although had an inventory loss reserve of $13.2 million in the first quarter of 1997, compared to a year-end 1996 loss reserve of $8.5 million, it still was too small. *Id.* Ernst posted to its "Summary of Audit Differences" or "SAD," outlining areas in which Ernst disagreed with its client, a total of $5.8 million for which it considered Fruit's reserves to be inadequate. R28 Complaint: ¶¶ 97, 98, pgs. 40-41, Apx. 127-128. The Summary also shows that Ernst knew Fruit was understating its reserves. *Id.* Ernst noted that Fruit's reserve for inventory loss was understated by $1.8 million:

> "Based upon the above analysis, we believe that the client should maintain a reserve for inventory loss of $15mm based on the low end of our range of estima-

> tion. As the client has recorded a reserve of $13,245 at 3/31/97, we will post the remaining difference of $1.8mm to the SAD."

R28 Complaint: ¶ 99, pg. 41, Apx. 128. But taking an adequate reserve would have hurt Fruit's earnings, and a more senior Ernst accountant struck out the instructions to post the difference to the SAD. *Id.*

Armed with additional facts like these—finally indicating a violation of § 10(b) by Ernst—the Pension Fund filed its suit against Ernst on June 28, 2000, less than a year after it had obtained the critical incriminating facts, and less than three years after Fruit's July and August 1997 securities offerings, for which Ernst had consented to use of its unqualified 1996 audit opinion.

Even then, Ernst contended in motions to dismiss, that the Pension Fund had been on inquiry notice of fraud for more than a year but still had no facts to state a claim. The district court rejected contentions that the Pension Fund was on inquiry notice as a matter of law, 15a n.1 & 32a-36a, ruling that even *with audit workpapers* the Pension Fund could not raise the "strong inference" of knowing or reckless misconduct required by Exchange Act § 21D(b)(2), 15 U.S.C. § 78u-4(b)(2), to state a claim against Ernst under § 10(b). *See* 19a-23a & 41a-45a. As a matter of law, it ruled, Ernst had not violated § 10(b). *See* 22a-23a.[2]

The Sixth Circuit affirmed—but on a different ground. Where the district court held that the Pension Fund could point to no facts sufficient to raise a strong inference of Ernst's scienter—a critical element of any § 10(b) violation—

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[2] The district court also ruled that claims based on Ernst's consent to use of its 1996 audit opinion in 1997 securities offerings were time barred by a three-year period of repose—even though the Pension Fund filed suit within three years of the offerings. 15a-19a & 37a-45a. The Sixth Circuit never reached this issue. 12a.

the Sixth Circuit ruled that Ernst's scienter should have been apparent from the outset, when the Pension Fund had filed its original case against Fruit. "We agree that scienter on the part of the corporate insiders—which New England plainly alleged in the Fruit complaint—does not necessarily imply scienter on the part of outside auditors," the Sixth Circuit wrote. 11a. Nonetheless, it held that from the very outset "the facts alleged in the Fruit complaint strongly suggest that Fruit's auditors were at least reckless." 11a. Ignoring procedural hurdles that the Pension Fund faced in developing its case, the Sixth Circuit held that its claims were barred under an inquiry-notice standard:

> For one thing, the alleged fraud relates primarily to departures from GAAP contained in audited financial statements—the "same issues," New England has said, that are addressed in the Ernst complaint—and not to representations that were neither scrutinized nor approved by the auditors. Moreover, the scope of the alleged fraud—involving overvaluation of fixed assets and inventory by more than $400 million, premature recognition of more than $50 million in sales, and failure to accrue liabilities and charges totaling $89 million—is such that any reasonable investor would question the auditors' oversight. As New England says in its brief, the fraud "does not involve little mistakes that the auditors might have easily overlooked." In the light of the particular allegations against Fruit, we are at a loss to understand why New England should not have determined, by July 1, 1998, that Ernst knowingly or recklessly participated in the alleged fraud.
>
> At the very least, New England should have made that determination during the 12 months that elapsed between July 1, 1998, and June 28, 1999—ample time, it seems to us, for a diligent investigation to establish Ernst's close involvement with Fruit's business. In sum,

> we are satisfied that New England can prove no set of facts showing that it lacked inquiry notice before June 28, 1999.

11a-12a.

Thus, the court held that the Pension Fund's claims are barred by Exchange Act § 9(e)'s one-year limitations period which, by its terms, requires an action to be "brought within one year after the discovery of the facts constituting the violation." 15 U.S.C. § 78i(e). The Sixth Circuit flatly rejected the Pension Fund's contention that § 9(e)'s text requires actual "discovery of the facts constituting a violation," 15 U.S.C. § 78i(e), in stark contrast with the 1933 Act's adoption of an inquiry-notice standard for §11 and § 12(a)(2) claims, requiring suit to be filed "within one year after the discovery of the untrue statement or the omission, *or after such discovery should have been made by the exercise of reasonable diligence.*" 15 U.S.C. § 77m (emphasis added). The Sixth Circuit acknowledged that in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 n.9 (1991), this Court "explicitly chose § 9(e) over § 13 and other one-year/three-year limitations periods set out in the 1933 and 1934 Acts." 8a. But the Sixth Circuit believed that §13's standard was a better fit for § 10(b) claims and applied it anyway, following Judge Posner's opinion for the Seventh Circuit in *Tregenza v. Great Am. Communs., Co.*, 12 F.3d 717, 722 (7th Cir. 1993).

The Pension Fund petitioned for rehearing, and for rehearing en banc, on the ground that the ruling conflicted with this Court's holding *Lampf* and that § 9(e)'s text controls. The Sixth Circuit denied rehearing on September 29, 2003. 13a.

REASONS FOR GRANTING THE WRIT

A. The Decision Below Conflicts this Court's Holding in *Lampf* that § 9(e)'s Statutory Text Controls Limitations Issues for § 10(b) Claims

This Court's opinion in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 n.9 (1991) commands lower courts to apply § 9(e)'s limitations provision to § 10(b) claims, and to follow § 9(e)'s text where it varies meaningfully from the other contemporaneously enacted limitations provisions in the securities laws. *Lampf*, 501 U.S. at 364 n.9. *Lampf* thus directs that fraud-based claims under 1934 Act § 10(b) shall be governed by the text of 1934 Act § 9(e)'s provision that suit must be "brought within one year after the discovery of the facts constituting the violation," 15 U.S.C. § 78i(e), and not by 1933 Act § 13's provision requiring certain non-fraud 1933 Act claims to be filed "within one year after the discovery of the untrue statement or the omission, *or after such discovery should have been made by the exercise of reasonable diligence*." 15 U.S.C. § 77m (emphasis added).

With the decision below, the Sixth Circuit has joined several other circuits in openly defying this Court's holding that lower courts must follow § 9(e)'s text in determining the timeliness of § 10(b) claims. *See* 8a-9a. Scholars have noted the circuit courts' open defiance.[3] The leading commentators write, in an article subtitled *The Circuits Defy The Supreme Court*, that "where the Supreme Court in *Lampf* opted for a one-year 'actual notice' trigger, the lower federal courts, particularly the circuit courts of appeals, have opted for a

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[3] *See, e.g.*, Lewis D. Lowenfels & Alan R. Bromberg, *SEC Rule 10b-5 and Its New Statute of Limitations: The Circuits Defy the Supreme Court*, 51 Bus. Law. 309, 313-14 (1996); Charles Benjamin Nutley, *Triggering the One-Year Limitations on Section 10(b) and Rule 10b-5 Actions: Actual or Inquiry Discovery?*, 30 San Diego L. Rev. 917, 927-28 (1993).

one-year 'inquiry notice' trigger."[4] The Ninth Circuit, too, has noted the clear conflict with this Court's authority: "On a literal reading of *Lampf*, those decisions appear to be 'contrary to the specific guidance issued by the Court.'" *Berry v. Valence Tech., Inc.*, 175 F.3d 699, 704 (9th Cir. 1999) (dictum) (quoting *Slavin v. Morgan Stanley & Co.*, 791 F. Supp. 327, 332 (D. Mass. 1992)).

Perhaps the most disturbing characteristic of this conflict is the fact that the circuit courts have justified it on the ground that they know better than this Court does what limitations provisions should govern § 10(b) claims. This Court chose § 9(e) because § 10(b) claims have the most in common with § 9(e). *See Lampf*, 501 U.S. at 360, 364 n.9. But the Seventh Circuit in *Tregenza*, 12 F.3d at 721-22, and now the Sixth Circuit in the decision below, have concluded that this Court was wrong. They think that § 10(b) claims are more like claims under §11 and § 12(a)(2) of the Securities Act of 1933 than they are like market-manipulation claims under § 9(e) of the 1934 Act. *See Tregenza*, 12 F.3d at 721-22. Thus these lower courts have concluded that, whatever this Court said in *Lampf*, § 13's inquiry-notice standard is a better fit for § 10(b) claims than 9(e) is. *See* 7a; *Tregenza*, 12 F.3d at 721-22.

"As the Seventh Circuit has pointed out," the decision below explains, "Congress could not have guessed in 1934 that § 9(e) would be applied to claims of fraud brought under § 10(b)—claims more closely resembling 'false statement' claims under §§ 11 and 12 of the 1933 Act, 15 U.S.C. §§ 77k and 77*l*, than 'market manipulation' claims under §9 of the 1934 Act, *id.* § 78i." 7a (citing *Tregenza*, 12 F.3d at 721-22). If this Court made a mistake in *Lampf* by ruling that § 9(e) should govern § 10(b) claims, instead of § 13's inquiry

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[4] *Lowenfels & Bromberg, supra* note 3, 51 Bus. Law at 314; *see also Nutley, supra* note 3, 30 San Diego L. Rev. at 927-28.

and notice provision, *see Lampf*, 501 U.S. at 364 n.9, the circuit courts have determined to correct it—by applying § 13's inquiry-notice standard anyway. *See* 8a; *Tregenza*, 12 F.3d at 721-22.

In fact, this Court made no mistake at all in *Lampf*. It chose § 9(e) quite deliberately.

While §§ 13 and 9(e) both adopt one and three-year limitations and repose periods, they promulgate three distinctly different standards for triggering one-year limitations periods on specific kinds of securities claims. Section 13 provides that strict-liability § 12(a)(1) claims for selling unregistered securities—a violation requiring no misleading statement—must be filed "within one year after the violation upon which it is based," *without regard to when plaintiffs discovered, or should have discovered the violation.*[5] But § 13 also provides that § 11 and § 12(a)(2) claims, requiring proof of a materially misleading statement or omission but no showing of scienter,[6] may be filed "within one year after the discovery of the untrue statement or the omission, *or after such discovery should have been made by the exercise of reasonable diligence*"—a reasonable-diligence inquiry-notice standard. 15 U.S.C. § 77m (emphasis added).

With § 9(e), however, Congress chose an actual-discovery standard, requiring market-manipulation claims to be filed

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[5] 15 U.S.C. § 77m; *see Cook v. Avien, Inc.*, 573 F.2d 685, 691-92 (1st Cir. 1978); *Gridley v. Cunningham*, 550 F.2d 551, 552-54 (8th Cir. 1977); *Blatt v. Merrill Lynch, Pierce, Fenner & Smith*, 916 F. Supp. 1343, 1353 (D.N.J. 1996).

[6] *See Gustafson v. Alloyd Corp.*, 513 U.S. 561, 578 (1995) (the 1933 Act provisions confer a "right to rescind, without proof of fraud or reliance"); *id.* at 582 ("liability without proof of either fraud or reliance"); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983); *Hochfelder*, 425 U.S. at 200.

"within one year after the *discovery* of the facts constituting the violation," 15 U.S.C. § 78i(e) (emphasis added), and deleting § 13's additional text about when discovery "should have been made by the exercise of reasonable diligence." 15 U.S.C. § 77m. Section 9(e)'s text could not be clearer, as Judge Posner himself acknowledged in *Tregenza:* "Section 9(e), read literally, requires actual knowledge to set the statute of limitations running." 12 F.3d at 721. "The plaintiff must know 'the facts constituting the violation,' not merely enough facts to make a reasonable person suspicious and start looking for the facts constituting the violation." *Id.*

This Court said it chose § 9(e) to control § 10(b) claims in *Lampf* precisely *because of* these differences in statutory text—which were called to its attention by the SEC's *amicus curiae* brief. *Lampf*, 501 U.S. at 364 n.9.[7] The *amicus* brief explained that § 9(e) uses an actual-discovery standard rather than a constructive or inquiry-notice standard like § 13's. "In particular," the SEC noted, "claims under Sections 11 and 12(2)—*unlike claims under Section 9* . . . of the 1934 Act—must be filed within one year of actual or *constructive* discovery ('after such discovery should have been made by the exercise of reasonable diligence')." 67a (emphasis added).

The SEC pointed out that Third Circuit decisions applied § 9(e)'s actual-discovery standard. 67a - 68a & n.34 (citing *In re Data Access Systems Sec. Litig.*, 843 F.2d 1537 (3d Cir. 1988) (en banc); *Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n.4 (3d Cir. 1990)). But the Seventh Circuit "mistakenly thought the Third Circuit had selected Section 13 of the 1933 Act," and proceeded to apply § 13's inquiry-notice standard

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[7] *See* SEC *amicus* brief in *Lampf*, Docket No. 90-333, at 21-23 (reproduced in the Appendix hereto, at 65a-68a). The decision below indicates that the Sixth Circuit "considered the SEC's brief," which the Pension Fund had submitted for its review. 8a n.2.

to § 10(b) claims instead. 68a. The Second Circuit, for its part, had applied § 18(c)'s limitations provisions—resulting in what the SEC called a "three way conflict generated by the courts of appeals." 68a.

The conflict called to this Court's attention by the SEC was one that it resolved by directing the lower courts to follow § 9(e)'s text, calling for actual discovery, and not § 13's with its inquiry-notice clause. *Lampf*, 501 U.S. at 364 n.9 Writing that the SEC "notes, correctly, that the various 1-and-3-year periods contained in the 1934 and 1933 Acts differ," this Court in *Lampf* expressly selected "as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act." *Lampf*, 501 U.S. at 364 n.9. Thus, the leading commentators observe, "in selecting [1934 Act] section 9(e) rather than [1933 Act] section 13 as the governing standard, the Court appears to have opted for an 'actual notice' rather than an 'inquiry notice' standard."[8]

Congress chose actual discovery for § 9 and § 10(b) claims which both require a showing of deliberate misconduct, and inquiry notice for § 11 and § 12(a)(2) claims, which require no showing of fraud. Where liability requires no showing of fraud, and may be avoided by some defendants upon a showing that they exercised reasonable diligence, *see* 15 U.S.C. §§ 77k(b)(3), 77*l*(a)(2), investors' failure to exercise correlative reasonable diligence may sensibly operate as a bar. *See* 15 U.S.C. § 77m. But a plaintiff's simple negligence should seldom bar claims for willful misconduct.[9] And

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[8] Lowenfels & Bromberg, *supra* note 3, 51 Bus. Law. at 312-13; *accord* Nutley, *supra* note 3, 30 San Diego L. Rev. at 927-28.

[9] *Dupuy v. Dupuy*, 551 F.2d 1005, 1017 (5th Cir. 1977) (when negligence is the standard for defendants' liability, "'it might be appropriate to allow due diligence to be exacted from the victim, but where liability of the defendant requires proof of intentional misconduct, the exaction of a due diligence standard from the plaintiff becomes irrational'") (citation omitted); *see Goodman v. Epstein*, 582 F.2d 388, 405

Lampf adopted § 9(e)'s limitation period for § 10(b) claims because § 9 "target[s] the precise dangers that are the focus of § 10(b)," by prohibiting "willful manipulation of security prices." 501 U.S. at 360.

In short, this Court's opinion in *Lampf*, statutory text, and the structure of the securities laws all indicate that the standard to trigger the limitations period for fraud-based § 10(b) claims is actual discovery, not constructive notice as several circuits now hold. *See* Lowenfels & Bromberg, *supra* note 3, 51 Bus. Law. 309; Nutley, *supra* note 3, 30 San Diego L. Rev. 917.

So do the limitations provisions' history. "In adopting the 1934 Act, the 73rd Congress also amended the limitations provision of the 1933 Act, adopting the 1- and 3-year structure for each cause of action contained therein," *Lampf*, 501 U.S. at 360; *see Hochfelder*, 425 U.S. at 210, while providing a different trigger for each of them. *Lampf*, 501 U.S. at 364 n.9. Congress' decision against including § 13's inquiry-notice clause in § 9 cannot be brushed aside as inconsequential: "It is well settled that '"where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."'" *Duncan v. Walker*, 533 U.S. 167, 173 (2001) (quoting *Bates v. United States*, 522 U.S. 23, 29-30 (1997) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983))).[10]

(7th Cir. 1978); *compare* RESTATEMENT (SECOND) OF TORTS § 552A & cmt. a (1977); *see also Pinter v. Dahl*, 486 U.S. 622, 635-36 (1988) (limiting *in pari delicto* defense to instances where plaintiff's culpability is equal to defendant's).

[10] The Securities Act of 1933 and the Securities Exchange Act of 1934 ordinarily must be construed *in pari materia*, as a single enactment. *See Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682, 692 (3d Cir. 1991) ("we are mindful that the 1933 and 1934 Acts should be construed

Yet the circuit courts have refused to follow this Court's mandate in *Lampf* that § 9(e)'s statutory text be honored. Judge Posner wrote for the court in *Tregenza*, for example, that:

> Section 9(e), read literally, requires actual knowledge to set the statute of limitations running. The plaintiff must know "the facts constituting the violation," not merely enough facts to make a reasonable person suspicious and start looking for the facts constituting the violation. On the same day that section 9(e) was enacted, Congress amended section 13 of the Securities Act of 1933, 15 U.S.C. § 77m, the Act that prohibits fraud in new issues of securities (Securities Act of 1933, §§ 11, 12(2), 15 U.S.C. §§ 77k, 77*l*(2)—and, we have held, in the aftermarket as well, *Pacific Dunlop Holdings Inc. v. Allen & Co.*, 993 F.2d 578 (7th Cir. 1993) [*overruled by Gustafson v. Alloyd Co.*, 513 U.S. 561 (1999)] – to make the limitations and repose periods the same as those of the Securities Exchange Act of 1934. But section 13 bars suit "unless brought within one year after the discovery of the untrue statement or the omission *or after such discovery should have been made by exercise of reasonable diligence.* 15 U.S.C. § 77m. And the Supreme Court held in *Lampf* that it is section 9(e) of the 1934 Act, not section 13 of the 1933 Act, that supplies the statute of limitations for Rule 10b-5 suits.

Tregenza, 12 F.3d at 721 (emphasis in original).

That should be clear enough. But Judge Posner decided that he was not bound by clear statutory text, and this Court's

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in pari materia"); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1298 n.65 (2d Cir. 1973) ("the 1933 and 1934 Acts are to be construed *in pari materia*"); *De Haas v. Empire Petroleum Co.*, 435 F.2d 1223, 1230 n.4 (10th Cir. 1970) ("courts have generally 'endeavored to treat the '33 and '34 Acts *in pari materia* and to construe them as a single comprehensive scheme of regulation'") (quoting *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1286 (2d Cir. 1969)).

directive in *Lampf*. "Congress could not have known when it enacted § 9(e) that this section would someday provide the statute of limitations for a wide range of securities frauds unrelated to the market manipulations forbidden by section 9," Judge Posner explained. *Tregenza*, 12 F.3d at 721. "The fact that Congress did not bother to specify inquiry notice need signify no more than that no one foresaw that the absence of such a provision would cause problems with respect to the particular misconduct singled out for prohibition in section 9." *Id.*

Congress could not have foreseen, in short, that this Court would err in *Lampf* by adopting § 9(e)'s limitations provision to govern § 10(b) claims, claims that Judge Posner believed should be governed instead by § 13. Judge Posner explained that "Sections 11 and 12(2) of the 1933 Act, on the one hand, and Rule 10b-5 under the 1934 Act, on the other, differ only in details." 12 F.3d at 721-22. Congress "did not know that section 9(e) of the 1934 Act would someday be applicable to the same type of fraud claim for which section 13 of the 1933 Act supplied the limitations period." *Id.* at 722. Thus, no matter what this Court held in *Lampf*, Judge Posner determined § 13 principles would control. *Id.*

Judge Posner is a brilliant jurist—one of the finest legal minds of our time. But he does not have the power to override this Court's decisions merely because he believes them to be mistaken. Neither does the Sixth Circuit, whose opinion in this case similarly rests on the view that *Lampf* should have chosen § 13 rather than § 9(e) to control § 10(b) claims. Citing *Tregenza*, the Sixth Circuit's opinion explains:

> As the Seventh Circuit has pointed out, Congress could not have guessed in 1934 that § 9(e) would be applied to claims of fraud brought under § 10(b)—claims more closely resembling "false statement" claims under §§ 11 and 12 of the 1933 Act, 15 U.S.C. §§ 77k and 77*l*, than

"market manipulation" claims under § 9 of the 1934 Act, *id.* § 78i. *See Tregenza*, 12 F.3d at 721-22.

7a.

These decisions effectively reject *Lampf*'s holding that § 9(e) controls—on the ground that § 10(b) claims are more similar to the § 11 or § 12 "fraud" claims, for which Congress provided § 13's inquiry-notice standard, than they are to the § 9 "manipulation" claims governed by § 9(e). Their analysis rests upon the faulty premise that § 10(b), § 11, and § 12 claims "differ only in details," because all supposedly require a showing of *fraud*. *Tregenza*, 12 F.3d at 722; *see* 7a. But this Court holds to the contrary—that only § 10(b) requires a showing of fraud, while § 11 and § 12 do not. *Hochfelder*, 425 U.S. at 193 & n.13, 208-09; *Herman & MacLean*, 459 U.S. at 382; *see supra* at 13 n.6. This Court holds that "§ 11 and § 10(b) address *different* types of wrongdoing," *Herman & MacLean*, 459 U.S. at 382, while § 9 "target[s] the precise dangers that are the focus of § 10(b)." *Lampf*, 501 U.S. at 360. *Lampf* thus holds that § 9(e)'s text controls, not § 13's. *Id.* at 364 n.9. *Tregenza* is wrong. Nutley, *supra* note 3, 30 San Diego L. Rev. at 950-56; Lowenfels & Bromberg, *supra* note 3, 51 Bus. Law. at 316-17, 332-34.

But confusion is so great in the lower courts that even the Third Circuit which, as the SEC's *Lampf amicus* brief pointed out, repeatedly held that §9(e) requires actual discovery of fraud, not mere inquiry notice,[11] recently reached the opposite conclusion in *In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1324-25 (3d Cir. 2002), without even citing its own contrary precedents. It adopted "the 'inquiry notice standard'" from *Gruber v. PriceWaterhouse*, 697 F. Supp. 859, 863 (E.D. Pa. 1988), without noticing that it had *rejected* that standard on appeal in *Gruber*. *Compare NAHC*, 306 F.3d at 1325 with

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[11] 67a-68a & n.34; *see Data Access*, 843 F.2d at 1550; *Gruber*, 911 F.2d at 964 n.4 (§ 9(e) simply "does not provide for inquiry notice").

Gruber, 911 F.2d at 964 n.4. Because a panel cannot overrule existing Third Circuit precedent, perhaps the earlier appellate decision controls. *See Holland v. New Jersey Dep't of Corr.*, 246 F.3d 267, 278 n. 8 (3d Cir. 2001); *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 354 (3d Cir. 1981).

Still, lower courts are in a state of disarray—and open defiance of *Lampf* should not be permitted to persist. Nor should investors be placed in the untenable position of the Pension Fund—told that it lost its claim because it diligently tried to comply with pleading reforms requiring it to develop facts raising a strong inference of auditor scienter before filing suit. *See supra* at 4-6. To discourage premature suits against deep-pocket defendants, Congress with the PSLRA, required plaintiffs to develop facts raising a strong inference of scienter *before* naming a defendant in a complaint. 15 U.S.C. § 78u-4(b)(2); H.R. Conf. Rep. No. 104-369, *reprinted in* 1995 U.S.C.C.A.N. 730; *see Comshare*, 183 F.3d at 548-49. Even before the PSLRA's passage, courts terminated many § 10(b) cases against accounting firms, holding that auditors could not be presumed to know of their client's improper accounting. *See supra* at 4.

The district court told the Pension Fund that under the controlling pleading standards it had filed *before* it had the facts needed to state a claim. Yet the Sixth Circuit ruled that despite its efforts, the Pension Fund had filed too late. The Sixth Circuit's decision adopts an unreasonable and unacceptable standard for inquiry notice that utterly ignores the heightened pleading standards and other procedural hurdles that investors must mount in order to frame a § 10(b) claim against auditors.

Something is clearly wrong here, and only this Court can fix it.

CONCLUSION

For the foregoing reasons, this Court should grant a writ of certiorari.

Respectfully submitted,

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December 29, 2003

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 01-6523

NEW ENGLAND HEALTH CARE EMPLOYEES PENSION FUND,
on Behalf of Itself and All Others Similarly Situated,
Plaintiff-Appellant,

v.

ERNST & YOUNG, LLP,
Defendant-Appellee.

Appeal from the United States District Court
for the Western District of Kentucky at Bowling Green.
No. 00-00124—Joseph H. McKinley, Jr., District Judge.

Argued: May 1, 2003
Decided and Filed: July 9, 2003

OPINION

Before: NELSON and COLE, *Circuit Judges*; ROSEN, *District Judge*.*

Private lawsuits impliedly authorized under § 10(b) of the 1934 Securities Exchange Act, the Supreme Court held in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501

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* The Honorable Gerald E. Rosen, United States District Judge for the Eastern District of Michigan, sitting by designation.

U.S. 350 (1991), are subject to the statutory limitations provision established in § 9(e) of the Act. Private securities fraud actions must thus be "brought within one year after discovery of the facts constituting the violation and within three years after such violation." *See* 15 U.S.C. § 78i(e).

The present action, a § 10(b) securities fraud case brought by an investor against an accounting firm, is barred by the one-year statute of limitations if the word "discovery," as used in the statute, extends to constructive discovery as well as actual discovery. The plaintiff investor having been put on "inquiry notice" of the alleged fraud more than one year before the filing of the complaint, in other words, the question is whether such notice suffices to bar the action.

Like a number of our sister circuits, we believe that inquiry notice is sufficient to trigger the running of the one-year limitations period. The district court dismissed this case on grounds that involved the three-year statutory period, among other things, but we shall affirm the dismissal under the one-year provision without reaching the grounds found persuasive by the district court.

I

This case has its origins in financial difficulties experienced by clothing manufacturer Fruit of the Loom, Inc. ("Fruit") in the 1990s. According to the plaintiff, Fruit's stock "collapse[d]" in November of 1995 as a result of market changes and poor management. Fruit took steps to improve performance in 1996, but it became clear by the fourth quarter that Fruit would not meet its financial goals for the year. Therefore, the plaintiff has alleged, Fruit's management instituted a "pull-forward" program of early shipments, which was designed to accelerate recognition of 1997 revenues into the fourth quarter of 1996. Fruit ended up reporting financial results for 1996 that were much higher than expected, and Fruit's stock rebounded.

Fruit's 1996 financial statements were audited by Ernst & Young, LLP ("Ernst"), the defendant herein. According to the plaintiff, the statements violated generally accepted accounting principles ("GAAP") by failing to write down overvalued inventory and fixed assets and failing to accrue certain liabilities, as well as by improperly recognizing 1997 revenue in 1996. In a report dated February 12, 1997, however, Ernst certified that Fruit's 1996 financial statements "present fairly, in all material respects, the consolidated financial position of [Fruit] . . . and the consolidated results of [its] operations and [its] cash flows . . . in conformity with generally accepted accounting principles." The report stated further that Ernst had conducted its audit of Fruit's statements "in accordance with generally accepted auditing standards" ("GAAS").

In March of 1997, Fruit filed its Form 10-K—which included the 1996 financial statements and Ernst's February 12 audit report—with the Securities and Exchange Commission ("SEC"). The next month, Fruit distributed the financial statements and Ernst's certification to its shareholders as part of an annual report. Also in April, Fruit reported its results for the first quarter of 1997—results that were down from the first quarter of 1996 and that fueled a decline in the value of Fruit stock. Fruit reported its second-quarter results, which were again below 1996 levels, in July. The plaintiff contends that Fruit's first and second quarter financial statements, which were reviewed by Ernst, departed from GAAP.

On July 9, 1997, Fruit filed a registration statement with the SEC in connection with a public offering of securities. The registration statement included Fruit's financial statements for 1996 and the first two quarters of 1997, incorporated Ernst's February 12 audit report by reference, and included a letter in which Ernst consented to the use of its report. On August 6, 1997, Fruit filed an amendment to the

July 9 registration statement. The amendment, like the original registration statement, incorporated Ernst's audit report and included Ernst's consent to the use of that report.

For the third and fourth quarters of 1997, Fruit reported large losses. In January of 1998, the value of Fruit's stock dropped to slightly more than half of what it had been in March of 1997.

On July 1, 1998, New England Health Care Employees Pension Fund ("New England"), undertaking to act on behalf of itself and other purchasers of Fruit stock, sued Fruit and several of its directors and officers for securities fraud. New England alleged that the defendants intentionally overstated earnings on Fruit's financial statements for 1996 and the first two quarters of 1997, and that the defendants made additional public statements about Fruit's performance and prospects that were intentionally false (including representations that the financial statements adhered to GAAP). Ernst was not named as a defendant.

While that case was pending, Fruit entered bankruptcy. Then, on June 28, 2000—nearly two years after the filing of the suit against Fruit—New England brought the present action against Ernst. New England's complaint, which substantially repeated the earlier allegations of fraud by Fruit and its directors and officers, alleged that Ernst participated in the fraud by certifying the 1996 financial statements as consistent with GAAP, stating that it audited the statements in accordance with GAAS, and consenting to the use of its audit report in Fruit's offering documents. According to New England, Ernst's statements and letters of consent were fraudulent because Ernst was aware of evidence contradicting Fruit's reported results for 1996 and the first two quarters of 1997.

Ernst moved for dismissal under Rule 12(b)(6), Fed. R. Civ. P., arguing that the action was time-barred and that New

England had failed to allege particular facts supporting an inference of scienter, i.e., an inference that Ernst either knew its statements to be false or was reckless in assessing their truth. The district court granted the motion. The court noted that Ernst's audit report of February 12, 1997, was made more than three years before the filing of suit, and it held that Ernst's consent letters of July 9 and August 6, 1997, did not re-start the three-year repose period prescribed by 15 U.S.C. § 78i(e). The court further held that New England had not pleaded "with particularity facts giving rise to a strong inference that [Ernst] acted with the required state of mind" in accordance with the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(2). The district court rejected Ernst's argument that the action was barred by the one-year statute of limitations, *see* 15 U.S.C. § 78i(e), holding that it was not necessarily true that New England knew or should have known of Ernst's alleged fraud before June 28, 1999.

The dismissal being without prejudice, New England filed an amended complaint against Ernst in March of 2001. Ernst again moved to dismiss the complaint, and the district court again granted the motion. The court rejected New England's argument that Ernst's consent letters constituted new misrepresentations—made within the three-year period of repose—that were materially different from the misrepresentations allegedly contained in the February 12 audit report. The court also held that New England still had not pleaded sufficient facts showing scienter. The complaint was dismissed with prejudice, and this timely appeal followed.

II

We review the dismissal of New England's complaint de novo. *See, e.g., In re Comshare, Inc. Securities Litigation*, 183 F.3d 542, 547 (6th Cir. 1999). In doing so, we may affirm the judgment of the district court on any ground supported by the record. *See id.* at 547-48.

A

Securities fraud litigation under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5, must be commenced, as we have seen, "within one year after the discovery of the facts constituting the violation . . . ." 15 U.S.C. § 78i(e); *see Lampf*, 501 U.S. at 364, where the Supreme Court borrowed the limitations provisions of § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e), for actions brought under § 10(b) and Rule 10b-5.

Reading the language of § 9(e), narrowly, New England argues that only actual discovery of fraud can start the one-year limitations period. Ernst counters that the period begins to run upon "inquiry notice" of fraud—meaning, under one interpretation, the point at which the plaintiff should have discovered the fraud through reasonably diligent inquiry.

New England is correct, of course, that § 9(e) refers only to "discovery" as the trigger of the limitations period. Unlike some other federal statutes of limitations—notably, § 13 of the Securities Act of 1933, which allows actions based on false offering documents to be brought "within one year after the discovery" of the false statement "or after such discovery should have been made by the exercise of reasonable diligence," 15 U.S.C. § 77m (emphasis added)—§ 9(e) does not expressly provide for inquiry notice.

That does not necessarily mean, however, that § 9(e) requires actual discovery of fraud before the limitations period will begin to run. The term "discovery," when used in a statute of limitations, can be broader than "actual discovery." *See, e.g., J. Geils Band Employee Benefit Plan v. Smith Barney Shearson, Inc.*, 76 F.3d 1245, 1254 (1st Cir.) (holding that "discovery," as used in a statute of limitations within the Employee Retirement Income Security Act, "encompasses both actual and constructive discovery"), *cert.*

denied, 519 U.S. 823 (1996). And there is good reason to interpret § 9(e)'s "discovery" as "includ[ing] constructive or inquiry notice, as well as actual notice." *Menowitz v. Brown*, 991 F.2d 36, 41 (2d Cir. 1993). If actual discovery were required, investors could extend the time for filing suit simply by refusing to investigate possible fraud. Thus, an actual discovery standard would encourage "the opportunistic use of federal securities laws to protect investors against market risk;" investors could wait to see whether a poorly performing stock recovered, reap investment profits if it did, and sue for damages if it did not. *Tregenza v. Great American Communications Co.*, 12 F.3d 717, 722 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994).[1] "This tactic is discouraged by the doctrine of inquiry notice . . . ." *Id.*

The fact that Congress expressly provided for inquiry notice in § 13 of the 1933 Act, without doing so in § 9(e), does not persuade us that "discovery" must be read as "actual discovery." As the Seventh Circuit has pointed out, Congress could not have guessed in 1934 that § 9(e) would be applied to claims of fraud brought under § 10(b)—claims more closely resembling "false statement" claims under § § 11 and 12 of the 1933 Act, 15 U.S.C. § § 77k and 77l, than "market manipulation" claims under § 9 of the 1934 Act, *id.* § 78i. *See Tregenza*, 12 F.3d at 721-22. Section 9(e)'s failure to use "inquiry notice" language, therefore, cannot support an inference that Congress intended the narrowest possible discovery standard to apply in actions arising under § 10(b). *See id.*Congress never focused on the question, because Congress never chose any statute of limitations for § 10(b)

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[1] Investors' ability to hedge against risk in this manner would be circumscribed by the three-year period of repose contained in § 9(e), *see* 15 U.S.C. § 78i(e), but, in the words of the Seventh Circuit, "[t]hree years is an age in the stock market." *Tregenza*, 12 F.3d at 722.

actions—actions that are, after all, creatures of the courts and not of the legislature. *See Lampf*, 501 U.S. at 358-59.

The Supreme Court, on the other hand, did choose a statute of limitations for § 10(b) actions, and it explicitly chose § 9(e) over § 13 and other one-year/three-year limitations periods set out in the 1933 and 1934 Acts. *See id.* at 364 n.9. But while acknowledging that "slight[]" differences in terminology could someday "prove significant," *id.*, the Court characterized the various limitations provisions as essentially the same: "Although not identical in language, all these relate to one year after discovery and to three years after violation." *Id.* at 355 n.2. Finding no indication that the Court believed § 9(e) to be meaningfully different from § 13—or, more to the point, that the Court considered the absence of an express reference to inquiry notice in § 9(e) to be significant—we do not think the Court's choice of § 9(e) forecloses an interpretation of "discovery" that includes inquiry notice.[2]

We therefore join the courts of appeals of at least seven other circuits in holding that inquiry notice is sufficient to trigger the one-year limitations period for actions brought under § 10(b). *See LC Capital Partners v. Frontier Insurance Group*, 318 F.3d 148, 154 (2d Cir. 2003); *In re NAHC, Inc. Securities Litigation*, 306 F.3d 1314, 1324-25 (3d Cir. 2002); *Young v. Lepone*, 305 F.3d 1, 8 (1st Cir. 2002); *Theoharous v. Fong*, 256 F.3d 1219, 1228 (11th Cir. 2001); *Sterlin v. Biomune Systems*, 154 F.3d 1191, 1196 (10th Cir. 1998); *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 670 (7th Cir. 1998), *cert. denied*, 525 U.S. 1114 (1999); *Howard*

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[2] In reaching this conclusion, we considered the SEC's brief as amicus curiae in *Lampf*, as well as the other materials that New England submitted for judicial notice. Ernst's motion to strike the request for judicial notice is denied.

v. Haddad, 962 F.2d 328, 330 (4th Cir. 1992).[3] None of our sister circuits, so far as we know, has held that constructive discovery cannot suffice to start the one-year clock running.[4]

Before we turn to the application of § 9(e) to the facts of this case, we need to consider when the limitations period begins to run under an "inquiry notice" standard. Ernst suggests that the limitations period is triggered when the plaintiff learns facts that would cause a reasonable investor to investigate the possibility of fraud. Some cases support that suggestion. *See, e.g., Theoharous*, 256 F.3d at 1228. The majority view, however, is that knowledge of suspicious facts—"storm warnings," they are frequently called—merely

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[3] Ernst suggests that this circuit endorsed the inquiry notice standard for § 10(b) actions in *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1155 (6th Cir. 1994). The passage that Ernst quotes, however, merely characterizes the holding of *Lampf*:

> "In *Lampf*, the Supreme Court held that all actions under section 10(b) and Rule 10b-5 must be brought within one year from the time the fraud was discovered or should have been discovered, but no more than three years from the transaction giving rise to the claim." 27 F.3d at 1155.

This gloss on *Lampf—i.e.*, the insertion of the phrase "or should have been discovered" into *Lampf's* literal holding—was not essential to our decision in *Ockerman*, as the sufficiency of inquiry notice was not at issue in that case. We thus agree with New England that *Ockerman* does not control the case at bar.

[4] The Ninth Circuit has indicated—in dictum—an inclination toward the actual discovery standard. *See Berry v. Valence Technology, Inc.*, 175 F.3d 699, 703-04 & n.6 (9th Cir.), *cert. denied*, 528 U.S. 1019 (1999). For the reasons given above, we are not persuaded by the Ninth Circuit's analysis.

The Third Circuit's position on this issue has not always been clear, but in 2002, answering what it termed "an open question in this court," that circuit applied the inquiry notice standard under § 9(e). *See NAHC*, 306 F.3d at 1325.

triggers a duty to investigate, and that the limitation period begins to run only when a reasonably diligent investigation would have discovered the fraud. *See, e.g., Young*, 305 F.3d at 9-10; *Rothman v. Gregor*, 220 F.3d 81, 97 (2d Cir. 2000); *Sterlin*, 154 F.3d at 1201-02; *Marks v. CDW Computer Centers, Inc.*, 122 F.3d 363, 367-68 (7th Cir. 1997). This view, we believe, reflects an appropriate balance between "the staunch federal interest in requiring plaintiffs to bring suit promptly . . . and the equally strong interest in not driving plaintiffs to bring suit . . . before they are able, in the exercise of reasonable diligence, to discover the facts necessary to support their claims." *Young*, 305 F.3d at 9 (citing *Sterlin*, 154 F.3d at 1202). We conclude, in accordance with the majority view, that the § 9(e) limitations period begins to run when a plaintiff should have discovered, by exercising reasonable diligence, the facts underlying the alleged fraud.

B

Like other Rule 12(b)(6) motions to dismiss, a motion to dismiss on statute of limitations grounds should be granted "when the statement of the claim affirmatively shows that the plaintiff can prove no set of facts that would entitle him to relief." *Ott v. Midland-Ross Corp.*, 523 F.2d 1367, 1369 (6th Cir. 1975), quoted in *Duncan v. Leeds*, 742 F.2d 989, 991 (6th Cir. 1984). A court that is ruling on a Rule 12(b)(6) motion may consider materials in addition to the complaint if such materials are public records or are otherwise appropriate for the taking of judicial notice. *See, e.g., Jackson v. City of Columbus*, 194 F.3d 737, 745 (6th Cir. 1999), abrogated on other grounds, *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506 (2002). New England's complaint against Fruit, therefore, is properly a part of the record before us.

Reading New England's amended complaint against Ernst in conjunction with New England's earlier complaint against Ernst's client, Fruit of the Loom, we believe that New England can prove no set of facts showing that it failed to

discover Ernst's alleged fraud, either actually or constructively, before June 28, 1999. No later than July 1, 1998, when it filed the complaint against Fruit, New England was aware that Fruit's financial statements for 1996 (and the first two quarters of 1997) did not adhere to GAAP. New England also knew, or could have learned through minimal investigation of public records, that Ernst had audited Fruit's 1996 statements and declared them to be in conformity with GAAP. New England obviously knew enough by July 1, 1998, to conclude that Ernst's certification was false.

New England argues that it could not have known whether Ernst's certification was knowingly or recklessly false until it obtained Ernst's workpapers through discovery in the Fruit litigation. We agree that scienter on the part of corporate insiders—which New England plainly alleged in the Fruit complaint—does not necessarily imply scienter on the part of outside auditors. At the same time, however, direct evidence of scienter is not necessary to a determination of fraud. *See, e.g., Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983) (noting that scienter may be proved with circumstantial evidence). In this case, we believe, the facts alleged in the Fruit complaint strongly suggest that Fruit's auditors were at least reckless.

For one thing, the alleged fraud relates primarily to departures from GAAP contained in audited financial statements—the "same issues," New England has said, that are addressed in the Ernst complaint—and not to representations that were neither scrutinized nor approved by the auditors. Moreover, the scope of the alleged fraud—involving overvaluation of fixed assets and inventory by more than $400 million, premature recognition of more than $50 million in sales, and failure to accrue liabilities and charges totaling $89 million—is such that any reasonable investor would question the auditors' oversight. As New England says in its brief, the fraud "does not involve little mistakes

that the auditors might have easily overlooked." In the light of the particular allegations against Fruit, we are at a loss to understand why New England should not have determined, by July 1, 1998, that Ernst knowingly or recklessly participated in the alleged fraud.

At the very least, New England should have made that determination during the 12 months that elapsed between July 1, 1998, and June 28, 1999—ample time, it seems to us, for a diligent investigation to establish Ernst's close involvement with Fruit's business. In sum, we are satisfied that New England can prove no set of facts showing that it lacked inquiry notice before June 28, 1999.

III

Having concluded that New England's complaint is untimely under the statute of limitations, we need not address the complaint's timeliness under the three-year statute of repose or the sufficiency of the allegations of scienter. Our conclusion also compels a determination that the district court did not err in dismissing the amended complaint with prejudice. Because of the time bar, further amendment of the complaint would be futile. *See, e.g., Deutsch v. Turner Corp.*, 317 F.3d 1005, 1029 n.20 (9th Cir. 2003).

AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

[Filed September 29, 2003]

No. 01-6523

NEW ENGLAND HEALTH CARE EMPLOYEES PENSION FUND,
on Behalf of Itself and All Others Similarly Situated,
Plaintiff-Appellant,

v.

ERNST & YOUNG, LLP,
Defendant-Appellee.

Before: NELSON and COLE, *Circuit Judges*; and ROSEN,* *District Judge*.

ORDER

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

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* Hon. Gerald E. Rosen, United States District Judge for the Eastern District of Michigan, sitting by designation.

APPENDIX C

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
BOWLING GREEN DIVISION

CIVIL ACTION NO. 1:OOCV-124-M

NEW ENGLAND HEALTH CARE
EMPLOYEES PENSION FUND, ETC.,
Plaintiff,

v.

ERNST & YOUNG, LLP,
Defendant.

October 24, 2001, Decided
October 29, 2001, Entered

MEMORANDUM OPINION AND ORDERS
ON DEFENDANT'S MOTION TO DISMISS
PLAINTIFF'S AMENDED COMPLAINT

This matter is before the Court on motion of the Defendant, Ernst & Young, LLP, [DN 33] to dismiss the Plaintiff's amended complaint pursuant to Fed R Civ P 12(b)(6) and the Private Securities Litigation Reform Act. The Plaintiff has filed a response, to which the Defendant has replied. The Court has reviewed the parties' filings and the record herein and its rulings are set forth below.

I. BACKGROUND

By Memorandum Opinion and Order entered herein on December 20, 2000, the Court granted the Ernst & Young's motion to dismiss the Plaintiff's original complaint, finding (1) that the complaint was time barred pursuant to the three

year statute of repose for federal securities fraud claims set forth in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991); and (2) that the complaint failed to plead facts giving rise to a strong inference that Ernst & Young either intentionally or recklessly committed securities fraud as required by the Private Securities Litigation Reform Act ("PSLRA").

On March 29, 2001, the Plaintiff's filed an amended complaint pursuant to Fed. R. Civ. P. 15(a) in an attempt to cure the fatal deficiencies of the original complaint The Defendant has again moved for dismissal. As will be discussed herein, the Court again finds the Plaintiff's allegations insufficient The motion will be granted.

II. DISCUSSION

The Plaintiff contends that the amended complaint: (A) alleges "additional facts" demonstrating that the claims are not barred by the three year statute of repose; and (B) alleges additional facts" from which to infer that Ernst & Young either intentionally or recklessly committed securities fraud. Both claims are discussed below.[1]

A. Whether the Amended Complaint is Time Barred

Both the original complaint and the amended complaint are based on the following representations by Ernst & Young:

1. February 12, 1997: Ernst & Young represented that it had conducted its audits of the 1996 Fruit of the Loom financial statements in accordance with generally accepted accounting standards, and that the

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[1] In the earlier memorandum opinion, the Court declined to find that dismissal was warranted by the one-year inquiry notice statute of limitations. *See* Mem. Op., pp. 9-14. The Defendant now contends that *Whitlock Corp. v. Déloitte & Touche, LLP*, 233 F.3d 1063 (7th Cir. 2000) is dispositive of this issue. The Court is not persuaded by this Seventh Circuit case applying Illinois state law. Dismissal is not proper on this ground.

financial statements fairly represented the company's financial position in conformity with generally accepted accounting principles.

2. March 26, 1997: The February 12, 1997 representations are repeated in Fruit of the Loom's Form 10-K filed with the SEC.

3. April 1, 1997: The February 12, 1997 representations are repeated in Fruit of the Loom's 1996 Annual Report to shareholders.

4. July 9, 1997: Ernst & Young gives its "consent" allowing Fruit of the Loom to repeat the February 12, 1997 representations in connection with the company's Registration Statement for a proposed sale of securities.

5. August 6, 1997: Ernst& Young gives "consent" allowing Fruit of the Loom to repeat the February 12, 1997 representations in connection with an amendment to the July 9 Registration Statement.

Whether the complaint clearly reveals that the relief sought is time barred is properly subject of a Rule 12(b)(6) motion to dismiss for failure to state a claim upon which relief can be granted. *See Rauch v. Day & Night Mfg. Corp.*, 576 F.2d 697, 702 (6th Cir. 1978). Federal securities fraud claims are subject to a one year statute of limitations and a three year statute of repose. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U S 350, 364 (1991) ("Litigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation.").

The Plaintiff sought to treat the original complaint as alleging multiple misrepresentations, contending that the three year "repose period begins when the last alleged misrepresentation was made[.]" *Continental Bank National Ass'n*

v. Ludlow, 777 F. Supp 92, 102 (D.Mass. 1991). Under the Plaintiff's theory, each time the February 12, 1997 report was repeated in a later document, or its subsequent use was consented to by the Defendant, a new three year period began.

In its previous opinion, the Court first found that because the complaint was filed on June 28, 2000,

> the original report, and the first two alleged repetitions, occurred more than three years prior to filing and thus any claims based upon them are time barred. If the Plaintiff's complaint here is to be timely, it must be based on the consent letter in Fruit's Registration Statement and/or the later amendment thereto.

Mem. Opp. 15.

The Court then noted that because "the consents expressly state that the February 12, 1997 report had already been filed with Fruit's Form 10-K," they "do nothing more than to allow Fruit to use, in a filing with the SEC, the exact document which it had previously used in another filing with the SEC." *Id.* at 16. After a [*sic*] discussing and rejecting the Plaintiffs arguments, the Court found that

> if a misrepresentation actionable under Rule 10b-5 was made, it was made on February 12, 1997. Any subsequent republication of that misrepresentation, even if made with Ernst's consent, does not act to trigger a new *Lampf* three year repose period.

id. at 19. Since the February 12 statement was made more than three years before the plaintiff filed suit, the claims were deemed untimely. By way of a footnote at the end of that discussion, the Court noted that

> That is not to say that there could be no set of circumstances where the reprinting or republication of a printed statement would trigger a new three year repose period. For example, the same result might not be

> warranted if the statements differed in some material way, or if the same statement was made to entirely different audiences (rather than to the SEC). On the facts of this case, neither of these considerations are implicated.

Id. at 18 n. 16. The Plaintiff has seized upon this comment as the basis for its arguments here. It now contends that the Defendant's "formal 'consent' to republication ... was in fact new, and materially different statement[.]" (Pl.'s Resp., p. 5.)

The consents, submitted as part of Fruit's Registration Statement (SEC Form S-3), filed with the SEC on July 9, 1997, and Amendment No. 1, filed on August 6, 1997, state that:

> We consent to the reference to our firm under the caption "Experts" . . . and to the incorporation by reference therein of our report dated February 12, 1997, . . . included in [Fruit's] Annual Report (Form 10-K) for the year ended December 31, 1996, filed with the Securities and Exchange Commission.

(Am. Compl., paras. 46, 49). The consent is not a misrepresentation, a required element of securities fraud claim, *see Aschinger*, 934 F 2d at 1409, to the contrary, it is an undeniably true statement. Nevertheless, the Plaintiff argues that, when read in conjunction with certain SEC filing requirements, and then in conjunction with certain accounting standards and principles, the consents "mean" that the Defendant "knew nothing on July 9, 1997 that would alter its earlier [February 12, 1997] conclusion." (Pls. Resp., p. 5.) The Court can not agree.

The Plaintiff has cited to no legal authority to support the contention that securities fraud liability may be predicated on statements which are undeniably true, but that might be considered false if viewed in light of an unidentified, unincorporated and unreferenced securities regulation and further

in light of some unrelated professional "standard" or principle." The consents are not, as the Plaintiff argues, "new affirmative statement[s] that E&Y had learned of no GAAP violations in Fruit's interim financial statements."[2] (Pl.'s Resp., p. 9.) They are merely new affirmative statements that Ernst & Young had consented to the use of its February 12 report—a report that had already been filed with the SEC—in later filings.[3] On the facts presented here, the Court does not believe that the consents are misrepresentations or omissions that would trigger securities fraud liability.

For the reasons set forth in the Memorandum Opinion and Orders dismissing the original complaint, and for the additional reasons set forth above, the Court finds that the amended complaint fails to meet the three year statute of repose set forth in *Lampf*. Dismissal is proper.

B. Whether the Amended Complaint Alleges Sufficient Facts to Demonstrate the Defendant's Scienter

1. The "Additional Facts" Evidence

As discussed herein, the PSLRA demands that the facts alleged in the complaint give rise to a strong inference the defendant intentionally or recklessly committed securities fraud. The inferences from the fact must "leave little room

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[2] As the Defendant noted, the Plaintiff claims in some instances that the "implied" misrepresentation relates to the 1996 financial statements, (*see* Pl's Resp. p. 5), and at others that it relates to the unaudited 1997 financial statements, (*see* Pl's Resp. p. 9). The argument is unavailing in either case.

[3] As a part of this theory, the Plaintiff also argues that accountants have a duty to correct misstatements in prior financial statements they have discovered, and thus Ernst & Young is liable failing to correct the false February 12, 1997 report. The Plaintiff misses a step here. While the first assertion may be true, the amended complaint does not demonstrate that Ernst & Young did in fact discover any misrepresentations in that report requiring correction.

for doubt as to misconduct." *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001). In dismissing the Plaintiff's original complaint, the Court found that

> The complaint may sufficiently allege negligence on the part of the Defendant, however, when viewed as a whole, the Plaintiff's allegations of securities fraud are based on nothing more than speculation, guesswork and hindsight. The complaint fails to plead facts that give rise to a strong inference that the Defendant either intentionally or recklessly committed fraud, and thus does not comply with the pleading requirements set forth in the PSLRA

Mem. Op., p. 23. The earlier opinion also noted that

> The basis for many of the allegations regarding Ernst is simply that it was in a position to know and learn certain things, therefore, it must have learned such things. Then, assuming that Ernst was aware of these certain things and knew their significance, the complaint concludes that Ernst's disregard of them was reckless. Conclusory allegations such as these are insufficient in pleading a federal securities fraud claim.

Mem. Op., p. 21

To that end, the Plaintiff now argues that the amended complaint contains additional facts demonstrating that Ernst & Young "had access to adverse information, actively reviewed such information, knew of its significance, and consciously or recklessly disregarded" it (Pl.'s Resp. p. 12.) This is a distinction without a difference.

The Plaintiff cites to two examples of "adverse information" that it believes support this position: that Ernst & Young "uncovered" a $1 8 million understatement of inventory reserves; and that Ernst & Young "knew" that Fruit of the Loom did not record necessary inventory, accounts

receivable, and guarantee accruals (Pl.'s Resp., p 13.) It is noteworthy that the Plaintiff claims that this information was discovered by the Defendant in 1997 and was only relevant to its *unaudited* financial reports for that year.

At any rate, and assuming as it must that these examples are true, the Court can not find that Ernst & Young's conduct in the face of this knowledge raises a strong inference that it committed securities fraud. At best, it again would merely raise an inference of negligence or of violations of generally accepted accounting principles. "The failure to follow GAAP is, by itself, insufficient to state a securities fraud claim." *Hoffman v Comshare, Inc.*, 183 F. 3d 542, 553 (6th Cir. 1999); *see also Serabian v. Amoskeag Bank Shares. Inc.*, 24 F.3d 357, 362 (1st Cir. 1994); *Malone v. Microdyne Corp.*, 26 F.3d 471, 479 (4th Cir.1994); *Melder v. Morris*, 27 F.3d 1097, 1103 (5th Cir. 1994); *In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1426 (9th Cir. 1994).

The Plaintiff's "additional facts" are little more than additional conclusory arguments based on speculation, guesswork and hindsight. They do not give rise to a strong inference that Ernst & Young committed intentional or reckless fraud.

2. The Motive and Opportunity Evidence

The Plaintiffs amended complaint reasserts the allegations that Ernst & Young had the motive and the opportunity to commit securities fraud. In *Helwig v. Vencor, Inc.*, the Court of Appeals clarified this circuit's position on the use of motive and opportunity evidence.

The scienter element demands that the facts pled in securities fraud complaints give rise to a strong inference of reckless or intentional conduct Although facts demonstrating a defendant's "motive and opportunity are not substitutes for a showing of recklessness [or intent], they can be catalysts to fraud and so serve as external markers to the required state of

mind." *Helwig*, 251 F 3d at 550 and in certain cases such facts "may be of enough weight to state a claim under the PSLRA." *Id.* at 551. Nevertheless, it is the inferences drawn from the facts themselves, rather than their labels as "motive" or "opportunity," that must guide the Court's analysis. *See id.* at 550-51. In other words, the ultimate question is not whether the facts alleged in the complaint demonstrate motive and opportunity, but rather is whether those facts give rise to a strong inference of reckless or intentional fraud.

The Court's rejection of the motive and opportunity allegations was fully addressed in its earlier opinion. That reasoning is equally applicable here and need not be repeated. *See* Mem. Op., p. 22. The Plaintiff spends a great deal of time explaining how the Defendant' s motives to commit securities fraud could be inferred from the facts alleged, and how the opportunity to commit securities fraud could be inferred from the facts alleged. The Plaintiff fails to explain, however, how those facts give rise to a strong inference that Ernst & Young did in fact recklessly or intentionally commit securities fraud. Compelling motives and ample opportunities to commit securities fraud do not *ipso facto* create a strong inference that reckless or intentional securities fraud has actually been committed.

The Sixth Circuit left open the possibility that certain fact patterns involving allegations of motive and opportunity could, without more, be sufficient to survive a motion dismiss. *Helwig*, 251 F.3d at 551. This Court does not believe that the facts presented here are such a case. Nor do the motive and opportunity allegations, coupled with the alleged GAAP violations, raise the required strong inference of misconduct.

For the reasons set forth in the Memorandum Opinion and Orders dismissing the original complaint, and for the additional reasons set forth above, the Court finds that the amended complaint fails to demonstrate that the Defendant

acted with the requisite state of mind and therefore is insufficient to satisfy the PSLRA. Dismissal is proper.[4]

III. CONCLUSION and ORDERS

For the reasons set forth above, IT IS HEREBY ORDERED that:

1. The Defendant's motion to dismiss the Plaintiff's amended complaint [DN 33] is GRANTED; and

2. The Plaintiff's motion for leave to file a second amended complaint [DN 36] is DENIED.

This the 24th day of October, 2001.

JOSEPH H. MCKINLEY, JR.
Judge, United States District Court

[Entered October 29, 2001]

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[4] In a footnote on the final page of its response brief, the Plaintiff seeks leave to amend should the Court again find its complaint insufficient to survive a motion to dismiss. Inasmuch as the Plaintiff has now had two opportunities to plead its case, that request will be denied.

APPENDIX D

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
BOWLING GREEN DIVISION

CIVIL ACTION NO. 1:00-C V-124-M

NEW ENGLAND HEALTH CARE
EMPLOYEES PENSION FUND, ETC.,
Plaintiff

v.

ERNST & YOUNG, LLP
Defendant

December 15, 2000, Decided
December 20, 2000, Entered

MEMORANDUM OPINION AND ORDER ON
DEFENDANT'S MOTION TO DISMISS

This matter is before on Court on motion [DN 5] of the Defendant, Ernst & Young, LLP, to dismiss the Plaintiff's complaint pursuant to Fed. R. Civ. P. 12(b)(6). The Plaintiff's [*sic*] have filed a response, to which the Defendant has replied. The Court has reviewed the parties' filings and the record herein and its rulings are set forth below.

I. BACKGROUND

A. Federal Securities Law

The federal government began regulating securities transactions "as part of the aftermath of the market crash in 1929." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 (1976)

Congress enacted two landmark statutes regulating securities during the New Deal: the Securities and Exchange [*sic*] Act of 1933 ("1933 Act"), and the Securities and [*sic*] Exchange Act of 1934 ("1934 Act"). *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 727-728 (1975). The 1933 Act focuses on disclosure and fraud in connection with offerings of securities—primarily initial distributions of newly issued stock from corporate issuers. *Id.* at 752. The 1934 Act, at issue here, is chiefly concerned with regulating securities trading on the stock exchanges and securities trading markets—and "was designed to protect investors against manipulation of stock prices." *Basic, Inc. v. Levinson*, 485 U.S. 224, 230 n.1 (1988).

Section 10(b) of the 1934 Act makes it unlawful for any person to use or employ any manipulative or deceptive device or contrivance in connection with the purchase or sale of securities. 15 U S C § 78j. Pursuant to its authority under the 1934 Act, the Securities and Exchange Commission[1] promulgated Rule 10b-5. *See Basic*, 485 U.S. at 230.

Rule l0b-5 provides that it shall be unlawful for any person, directly or indirectly, in connection with the purchase or sale of any security, to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact, or to omit to state a material fact necessary in order to make a statement made not misleading, or to engage in any act which would operate as fraud or deceit.[2] 17 CFR § 240. 10b-5 (1990).

To maintain a 10b-5 action a plaintiff must show (1) a misrepresentation or omission, (2) a purchase or sale of securities in connection with that misrepresentation or omission, (3) scienter, (4) the materiality of the misrepresentation or omission, (5)

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[1] The Securities and Exchange Commission ("SEC") was created by Congress as part of the 1934 Act. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976).

[2] For the purposes of this memorandum and unless otherwise noted, all actions brought under §10(b) of the 1934 Act and SEC Rule 10b-5 are referred to as "10b-5" actions.

justifiable reliance by the plaintiff on the misrepresentation or omission; and (6) damages causally related to the misrepresentation or omission. *Platsis v. E.F. Hutton & Co.*, 946 F.2d 38, 40 (6th Cir. 1991).

Liability under Rule 10b-5 does not attach, as such, for "aiding and abetting." Rather, all persons or entities—such as lawyers and accountants—who employ a manipulative device or make a material misstatement or omission on which a purchaser or seller of securities relies may be held primarily liable under Rule 10b-5 if all of the requirements are otherwise met.[3] *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994).

B. Factual Overview and Procedural History

1. The Fruit Case

In 1998, this Plaintiff filed an action in this Court, alleging that during 1996 and 1997, Fruit of the Loom, Inc. ("Fruit") and several of its officers and directors violated Section 10(b) and Rule 10b-5 "by, among other things, falsifying Fruit's financial statements for 1996 and the first two quarters of 1997." (PL's

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[3] Accountants may be held liable under federal securities law for their representations—such as certification of financial statements or statements in SEC filings—as auditor to a firm selling securities. *Anixter v. Home-Stake Production Co.*, 77 F.3d 1215, 1225 (10th Cir. 1996) (citing *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983)) (accountant liable for representations made in registration statements filed with the SEC). An accountant's false and misleading representations in connection with the purchase or sale of any security, if made with the requisite scienter and if relied upon by those purchasing or selling the security, may be actionable under § 10(b) and Rule 10b-5. *See id.* at 1226 (citing *Central Bank of Denver*, 511 U.S. at 191 (1994); *Frymire-Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 189-90 (7th Cir. 1993); *Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 526-27 (5th Cir.1992); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 34-35 (D.C. Cir.1987)); *see also DiLeo v. Ernst & Young*, 901 F.2d 624, 628 (7th Cir. 1990).

Resp., p. 1.) The *Fruit* case[4] has been certified as a class action, and this Plaintiff has been designated a lead plaintiff therein. The Defendant here, Ernst & Young, LLP ("Ernst"), was not named in the *Fruit* case.

A review of the *Fruit* allegations, filed July 1, 1998, some twenty-four months before the complaint was filed in this action, is beneficial here. This Court, finding that a "fraudulent scheme" had been adequately pled in the *Fruit* case, stated as follows in its order denying those defendants' motion to dismiss:

> The Complaint outlines in considerable detail the purported fraud at issue. It notes with specificity Fruit's financial condition at the outset of the alleged scheme, the beginning of 1996 after an unprofitable 1995; the details of the proposed "restructuring," including the re-pricing of the board of directors' bonus incentive plans, public announcements regarding changes made to boost investor confidence, moving some operations offshore, and new inventory and management organization systems which would aid productivity; the questionable "success" and implementation of these changes, including the failure of the organization systems and the poor performance of offshore operations; Fruit's reported (successful) financial condition, in the form of public filings such as the Earnings Per Share reports, upon which the officers' incentive bonuses were based; Fruit's actual activities including *questionable accounting procedures*, employee layoffs, and plant closings; and finally the revelation of massive reported losses, which revealed that Fruit was not doing as well as anticipated or reported.

Fruit Order Denying Motion to Dismiss, entered Aug. 16, 1999, p. 9 (emphasis added).

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[4] The *Fruit* case is styled *New England Health Care Employees Pension Fund. etc. v. Fruit of the Loom, Inc., et al.*, Civil Action No. 1:98-CV-99-M. There is currently pending a motion by this Plaintiff to consolidate these two cases pursuant to Fed. R. Civ. P. 42(a).

> Plaintiff alleges that specifically outlined public statements regarding Fruit's future, the purported status of the company, the expected returns and the status of the restructuring, made by the officers or by Fruit as an entity, were fraudulent because they were not true at the time they were made, based upon information either in the board's possession or reasonably within its knowledge. As mentioned above, this includes the failure of the overseas operations, the failure of the operations systems, and the increased inefficiency of the company as a result, *the use of "pull-forward" or "channel stuffing" accounting methods to inflate fourth quarter earnings*, and Fruit's loss of market share. The Complaint alleges that the company intentionally misrepresented the company's status to present and potential shareholders.

Id. at 10-11 (emphasis added).

The *Fruit* case also involves allegations that those defendants furthered their scheme to defraud the public by making false or misleading statements to analysts, who then made favorable market projections based upon that information. *Id.* at 12. Again summarizing the *Fruit* plaintiffs' complaint, the Court found that

> the statements in question are identified by date, analyst, and detail the conversations with specific members of Fruit's board upon which they were published. The Complaint further alleges how and why the statements were false, by averring that other, less positive information of a specific nature was in the Defendants' possession. Included in this is the fact that the overseas operations were failing, that the management and information systems were not working properly, that Fruit used *questionable accounting procedures* to project earnings, and that strong competition had weakened demand for Fruit's products, which were contrary to assertions made by officers to the analysts.

Id. at 13-14 (emphasis added).

Finally, the Court noted that the *Fruit* complaint is "replete with specific allegations" that those defendants carried out a scheme to inflate the stock price and/or to misrepresent the company's situation; that they knew or should have known information which placed the company's financial status in a light directly opposite to that which it propounded to the market; and that the individual *Fruit* defendants made misrepresentations in order to reap great personal gain at the expense of the company. *Id.* at 15.

2. The Ernst Case

On June 28, 2000, the Plaintiff filed its complaint in this action, seeking to hold Ernst, the accounting firm that audited Fruit's financial statements for 1996, liable for the following false statements:[5]

1. **February 12, 1997:** Ernst represented that it had conducted its audits of the 1996 Fruit financial statements in accordance with generally accepted accounting standards, and that the financial statements fairly represented Fruit's financial position in conformity with generally accepted accounting principles.

2. **March 26, 1997:** Ernst's February 12, 1997 representations are repeated in Fruit's Form 10-K filed with the SEC.

3. **April 1, 1997:** Ernst's February 12, 1997 representations are repeated in Fruit's 1996 Annual Report to shareholders.

4. **July 9, 1997:** Ernst gives "consent" allowing Fruit to repeat the February 12, 1997 representations in connection with Fruit's Registration Statement for a proposed sale of securities.

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[5] The Plaintiff contends that these statements were made as part of an alleged "fraudulent scheme." (*See* Pl's Resp., p. 2.) In other words, the Plaintiff claims that Ernst was a part of the fraud perpetuated by the *Fruit* insiders. Also notable is that the Plaintiff claims that this case and the *Fruit* case involve "identical allegations of accounting fraud." (Pl's Resp., p. 12.)

5. **August 6, 1997:** Ernst gives "consent" allowing Fruit to repeat the February 12, 1997 representations in connection with Fruit's amendment to the July 9 Registration Statement.

As shown above, this case focuses primarily on two representations by Ernst: (1) that it had conducted its audits of the 1996 Fruit financial statements in accordance with generally accepted accounting standards ("GAAS"); and (2) that the 1996 financial statements fairly represented Fruit's financial position in conformity with generally accepted accounting principles ("GAAP"). The Plaintiff contends that both of these statements were false. (Pl's Resp., p. 3.)

The first claim is that Ernst violated federal securities law because the audits of 1996 Fruit financial statements were *not* conducted in accordance with GAAS. The Plaintiff contends that Ernst should be liable here because it either intentionally conducted an insufficient audit that it knew did not conform to GAAS, or it was reckless in stating that its audit conformed to GAAS when in fact it did not.

The second claim is that the 1996 financial statements did *not* fairly represent Fruit's financial position in conformity with GAAP. The Plaintiff's theory of liability here is that Ernst either knew that the financial statements did not conform to GAAP, or recklessly disregarded that they did not.

The Plaintiff also claims that Ernst is liable for failing to insist that Fruit revise its financial statements for the first and second quarters of 1997 after Ernst learned that those statements were falsified. (Pl.'s Resp., p. 3; Compl. paras. 100-05.)

C. The Rule 12(b)(6) Standard

In ruling on a motion to dismiss under Rule 12(b)(6), the factual allegations in the complaint must be construed in a light most favorable to the plaintiff. *Pinney Dock Transport Co. v. Penn Central Corp.*, 196 F.3d 617, 619 (6th Cir. 1999). The "well-pleaded facts" in the complaint must be accepted as true.

Morgan v. Church's Fried Chicken, 829 F.2d 10, 12 (6th Cir. 1987). Such a motion should not be granted "unless it can be established beyond a doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Achterhof v. Selvaggio*, 886 F.2d 826, 831 (6th Cir. 1989). The burden is on the defendant to demonstrate that the plaintiff can prove no set of facts in support of his claim. *Windsor v. The Tennessean*, 719 F.2d 155, 158 (6th Cir. 1983). The issue is not whether the plaintiff will prevail on the merits, but rather is whether the plaintiff is entitled to offer evidence to support the claims. *Scheuer v Rhodes*, 416US 232, 236(1974).

Finally, when ruling on a motion to dismiss "it is appropriate to take judicial notice of public documents and consideration of these documents does not require conversion of defendant['s] motion to dismiss to a motion for summary judgment." *Helwig v. Vencor*, 210 F.3d 612, 619 (6th Cir. 2000).

II. DISCUSSION

The Defendant raises two core arguments supporting its claim that dismissal is proper under Fed. R. Civ. P. 12(b)(6). It first argues that the Plaintiff's complaint is time barred. Second, the Defendant claims that the complaint does not adequately demonstrate that the Defendant acted with the requisite scienter

A. Whether the Plaintiff's Complaint is Timely

"Litigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991). There can be no tolling of either period. *Id.* at 363.

Whether the complaint clearly reveals that the relief sought is barred by a statute of limitations or repose[6] is properly the subject of a Rule 12(b)(6) motion to dismiss for failure to state a claim upon which relief can be granted.[7] *See Rauch v. Day & Night Mfg. Corp.*, 576 F.2d 697, 702 (6th Cir. 1978).

1. The One Year Statute of Limitation

The first question to be addressed here is what triggers the one year limitation set forth in *Lampf*—simply put, when did "the discovery of the facts constituting the violation" occur? The Plaintiff, citing the plain language of § 9(e) of the 34 Act and the reasoning of the *Lampf* Court, contends that the one-year limitations period is triggered only by "actual discovery" of

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[6] The court in *Shadburne-Vinton v. Dalkon Shield Claimants Trust*, 60 F.3d 1071 (4th Cir. 1995) noted "the differences between statutes of limitation, which are procedural, and statutes of repose which are substantive." *Id.* at 1078.

> Statutes of limitation . . . are primarily instruments of public policy and of court management, and do not confer upon defendants any right to be free from liability, although this may be their effect. In contrast to statutes of limitation, statutes of repose serve primarily to relieve potential defendants from anxiety over liability for acts committed long ago. Statutes of repose make the filing of suit within a specified time a substantive part of plaintiff's cause of action. . . . In other words, where a statute of repose has been enacted, the time for filing suit is engrafted onto a substantive right created by law. The distinction between statutes of limitation and statutes of repose corresponds to the distinction between procedural and substantive laws.

Id. at 1078-79 (citing *Goad v. Celotex Corp.*, 831 F.2d 508, 511 (4th Cir.1987)) (internal quotations omitted).

[7] On a motion to dismiss, the fact that the claim is time barred must be clear from either the face of the complaint, *Rauch v. Day & Night Mfg. Corp.*, 576 F.2d 697, 702 (6th Cr. 1978), by reference to documents attached to the motion to dismiss which are referred to in the plaintiff's complaint and are central to the plaintiff's claim, *Jackson v. City of Columbus*, 194 F.3d 737, 745 (6th Cir. 1999), and/or by reference to those facts which the Court may properly take judicial notice. *Helwig v. Vencor*, 210 F.3d 612, 619 n.10 (6th Cir. 2000).

the fraud in question.[8] (Pl.'s Resp., p. 7.) The Defendant contends, on the other hand, that this limitation period is triggered by either actual or inquiry notice—in other words, either when the fraud is actually discovered or when it should have been discovered by a reasonable investor. (*See* Def's Mem., p. 11.)

The Court in *Lampf* was not called upon to address, and consequently, gave little guidance regarding what constitutes "discovery of the facts constituting the violation" sufficient to trigger this limitation period. While there is no Sixth Circuit case directly on point, other cases suggest that the interpretation urged by the Defendant is the correct one. In *Ockerman v May Zima & Co.*, 27 F 3d 1151(6th Cir 1994), the Sixth Circuit Court of Appeals, paraphrasing *Lampf*, stated that actions brought under section 10(b) and Rule 10b-5 "must be brought within one year from the time the fraud was discovered *or should have been discovered.*" *Id* at 1155 (citing *Lampf*, 501 U.S. 350 at 362-64) (emphasis added). This position is supported by *Caproni v Prudential Securities, Inc.*, 15 F.3d 614, 617 (6th Cir 1994) (the one-year limitation period begins to run on a claim of federal securities fraud "when the fraud is or should have been discovered") (citing *Herm v. Stafford*, 663 F.2d 669, 682 (6th Cir 1981)).

The Circuit Courts of Appeals that have addressed the question—the Second, Fourth, Fifth, Seventh and Tenth—have expressly held that inquiry notice is sufficient to trigger the

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[8] The *Lampf* Court noted that various one year and three year limitations periods contained in the 1933 and 1934 Acts differ slightly in terminology and selected the language of § 9(e) of the 1934 Act as the governing standard for actions brought under § 10(b). *Lampf*, 501 U.S. at 364 n.9. That language is as follows: "No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e).

Lampf one-year discovery statute of limitation.[9] The Plaintiff cites to only one other Circuit appellate decision that it claims "has held that plaintiffs must actually discover the fraud before the statute is triggered." (Pl.'s Resp., p. 7.) A reading of the case cited, however, does not bear out the Plaintiff's contention.

In *In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir. 1988), the Third Circuit addressed in 1988 the precise question that was ultimately decided by the Supreme Court in *Lampf* some three years later. Finding that federal securities law, rather than analogous state Blue Sky or common law, should provide the limitations periods for Rule 10b-5 actions, the *Data Access* court held simply that "the proper period of limitations . . . is one year after the plaintiff discovers

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[9] *See Lavian v. Haghnazari*, 884 F. Supp. 670, 677 (E.D.N.Y. 1995) (citing *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2d Cir. 1993)) (The one-year limitation "becomes operative upon the date in which the plaintiff is placed on notice of those facts which in the exercise of reasonable diligence, would have led to actual knowledge of the possibility of the fraud."); *Howard v. Haddad*, 962 2d 328, 330 (4th Cr. 1992) ("The one year discovery limitations period thus beg[ins] running either when [the plaintiff] had notice of these facts or when, exercising reasonable diligence, he would have discovered them."); *Caldarera & Co., Inc. v. Smith*, 2000 WL 1059856 at *2 (E.D. La. Aug. 2, 2000) (quoting *Jensen v. Snellings*, 841 F.2d 600, 606 (5th Cir. 1988)) (The one year "limitations period does not begin to run until the plaintiff discovers, or in the exercise of reasonable diligence should discover, the alleged frauduient conduct," and plaintiffs have "an affirmative duty of diligent inquiry into the facts of the alleged securities fraud" and are "not entitled to a leisurely discovery of the full details of the alleged scheme."); *Law v. Medco Research*, 113 F.3d 781, 786 (7th Cir. 1997) ("In other words, the plaintiff gets a year after he learned or should have learned the facts that he must know to know that he has a claim."); *Sterlin v. Biomune Systems*, 154 F.3d 1191, 1196 (10th Cir. 1998) (citing *Anixter v. Home-Stake Production Co.*, 939 F.2d 1420, 1437 (10th Cir. 1991)) (Inquiry notice is satisfied where there are "sufficient storm warnings to alert a reasonable person to the possibility that there were . . . misleading statements . . . involved in the sale.").

the facts constituting the violation, and in no event more than three years after such violation.[10] *Id.* at 1550.

The overwhelming weight of authority favors a holding that inquiry notice is sufficient to trigger the one year statute of limitations for Rule 10b-5 actions, and the Court therefore finds that this limitation is triggered at the time the Plaintiff knew or should have known of the facts that it now claims are the basis of its complaint. The Court must next address whether the Defendant has met its burden of showing that the Plaintiff possessed, or should have possessed, this knowledge for more than one year before filing the complaint herein. The question here becomes: has the Defendant shown that the factual allegations contained in the complaint were known (or should have been known) to the Plaintiffs more than one year prior to June 28, 2000?

The Defendant's position here is essentially that the Plaintiff's knowledge of the facts giving rise to the *Fruit* case demonstrate that it also had knowledge of the facts giving rise to this case. This is not necessarily true. There can be little doubt but that the Plaintiffs had a great deal of actual knowledge about the dealings of the *Fruit* defendants at the time it filed that complaint. (*See infra*, pp. 4-5.)

And there can be little dispute that, as early as July 1, 1998, the Plaintiff was aware that the *Fruit defendants* may have utilized questionable accounting procedures. Yet the Plaintiff's knowledge of the conduct of the *Fruit* defendants does not

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[10] Contrary to the Plaintiff's assertions here, the *Data Access* opinion in no way purported to find that actual notice is required, or even to define how the discovery period should be applied. The Third Circuit's reasoning was in fact very similar to that of the Supreme Court in *Lampf*. Also similar to *Lampf*, however, was that *Data Access* was primarily concerned with the *rationale* for finding a federal limitations period for federal securities fraud actions, and not with the *application* of that period to a particular case. The standard for discovery notice is mentioned nowhere in the decision.

automatically translate into knowledge of the conduct of Ernst, its outside auditor.

Dismissal of the complaint is proper on statute of limitations grounds only "when the statement of the claim affirmatively shows that the plaintiff can prove no set of facts that would entitle to relief." *Duncan v. Leeds*, 742 F.2d 989, 991 (6th Cir. 1984) (quoting *Ott v. Midland-Ross Corp.*, 523 F.2d 1367, 1369 (6th Cir.1975)). The Court does not believe that the Defendant has met it burden here.

The Plaintiff claims that it was first able to determine Ernst's involvement in the falsifications of the financial statements at issue here when Ernst responded to the Plaintiffs subpoena by producing its workpapers regarding those financial statements. (Pl's Resp., p. 1.) The Defendant makes much of the fact that the *Fruit* complaint and the instant complaint contain many of the same allegations and similar language; and that although the workpapers were provided to the Plaintiff, the complaint contains only one minor reference to them. *See* Complaint, para. 18.) The Defendant would have the Court infer from these "facts" that the Plaintiff discovered nothing new in Ernst's audit workpapers. This is not the proper inquiry in ruling on a Rule 12(b)(6) motion to dismiss.

It may in fact be true that the Plaintiff knew or should have known of the facts constituting the alleged 10b-5 violation(s) here prior to June 28, 1999, and those facts might be established during discovery. However, such a finding cannot be gleamed from the complaint itself, even when read in conjunction with the judicially-noticed *Fruit* complaint and the other evidence properly before the Court. The Court therefore finds that the Defendant has failed to meet its burden of showing—based upon the face of the complaint or other evidence upon which this Court may rely—that the Plaintiff could present no facts to show that its complaint was filed within one year of actual or inquiry notice of the alleged violations, and dismissal is not proper here.

2. The Three-Year Statute of Repose

The second issue to be addressed here is the trigger of *Lampf*'s three year statute of repose. "Litigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced . . . within three years after such violation" *Lampf*, 501 U.S. at 364. The parties here both claim that the repose period begins on the date of the alleged misrepresentation.[11] The parties disagree as to when the repose period began to run when applied to the facts of this case.

The Plaintiff seeks to treat this as a case involving multiple misrepresentations, and that therefore "[t]he repose period begins when the last alleged misrepresentation was made . . . ." *Continental Bank National Association v Ludlow*, 777 F. Supp. 92, 102 (D Mass 1991). Under the Plaintiff's theory, each time Ernst's February 12, 1997 report[12] was repeated in a later

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[11] Other courts have held that the purchase or sale of the security at issue, rather than the misrepresentation, is the triggering event, *See e.g., McCool v. Strata Oil Co.*, 972 F.2d 1452, 1460 (7th Cit. 1992) ("In securities fraud cases, the federal rule is that the plaintiff's cause of action accrues 'on the date the sale of the instrument is completed.'") (quoting *Suslick v. Rothschild Securities Corp.*, 741 F.2d 1000, 1005 (7th Cir.1984)).

The *Lampf* Court expressly found that the plaintiffs' complaint was time barred because it had been filed more than three years after the alleged misrepresentations. It is noteworthy, however, that "the [*Lampf*] Court did not need to address whether the statute of limitations begins to run from the date of purchase or the date of alleged misrepresentations since in that case both events occurred well over three years prior to the filing of the complaint." *Randolph County Federal Savings & Loan Ass'n v. Sutliffe*, 775 F. Supp. 1113, 1122 n.10(S.D. Ohio 1991).

[12] The February 12, 1997 report is quoted, purportedly in its entirety, in paragraph 91 of the Plaintiff's complaint. In effect, the report states (1) that financial statements are the responsibility of *Fruit* management; (2) that Ernst audited the financial statements in accordance with GAAP; and (3) that, as a result of its audit, Ernst was of the opinion that the financial statements fairly present Fruit's financial position in accordance with GAAP.

document, or its subsequent use was consented to by the Defendant, a new three year period began.

As previously stated, the Plaintiff claims that there were five false statements, made: on February 12, 1997 (the original report); March 26, 1997 (repeated in Fruit's SEC Form 10-K); April 1, 1997 (repeated in Fruit's annual' report to stockholders); July 9, 1997 (repeated, with "consent," in Fruit's Registration Statement); and August 6, 1997 (repeated, with "consent," in Fruit's amendment to the Registration Statement). According to the Plaintiff, a viable Rule 10b-5 cause of action could be timely brought within three years of August 6, 1997.

The complaint was filed on June 28, 2000. There can be no disagreement but that the original report, and the first two alleged repetitions, occurred more than three years prior to filing and thus any claims based upon them are time barred. If the Plaintiff's complaint here is to be timely, it must be based on the consent letter in Fruit's Registration Statement and/or the later amendment thereto.

The complaint references the following representation by Ernst, which was submitted as part of Fruit's Registration Statement (SEC Form S-3), filed July 9, 1997, and Amendment No. 1, filed August 6, 1997:[13]

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[13] The full consents, as referenced in the complaint, read as follows:

> We consent to the reference to our firm under the caption "Experts" in the [Registration Statement and Amendment No. 1] and related Prospectus of Fruit of the Loom, Inc. for the registration of Debt Securities, Preferred Stock and Class A Common Stock at an aggregate initial offering price not to exceed $850,000,000 and to the incorporation by reference therein of our report dated February 12, 1997, with respect to the consolidated financial statements and schedule of Fruit of the Loom, Inc. included in its Annual Report (Form 10-K) for the year ended December 31, 1996, filed with the Securities Exchange Commission.
>
> /s/ Ernst & Young, LLP

(Compl., paras. 57, 59)

> We consent to the reference to our firm under the caption "Experts" . . . and to the incorporation by reference therein of our report dated February 12, 1997, . . . included in [Fruit's] Annual Report (Form 10-K) for the year ended December 31, 1996, filed with the Securities and Exchange Commission.

The consents expressly state that the February 12, 1997 report had already been filed with Fruit's Form 10-K (filed on March 26, 1997). As such the consents do nothing more than to allow Fruit to use, in a filing with the SEC, the exact document which it had previously used in another filing with the SEC.

The Plaintiff's argument is that "[t]he fact that [Ernst] repeated the same misrepresentation five times does not mean that it only made one statement and that only one of the misrepresentations is actionable." (Pl's Resp., p. 2 n.3.) The Plaintiff places its sole reliance on *Continental Bank*, 777 F. Supp at 102, and cites to no other cases to support its contention here,[14] nor has the Court found any. However, the reasoning of that opinion is in fact harmful to the Plaintiff's position for two reasons. It does not purport to apply to repetitions of the same statement. Further, application of that holding to these facts would lead to precisely the undesirable result that the *Continental Bank* court sought to avoid.

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[14] The Plaintiff also cites *Durning v. Citibank. Int'l*, 990 F.2d 1133 (9th Cir. 1993), as adopting the holding of *Continental Bank*. But a closer reading of *Durning* reveals that the court cited *Continental Bank* for the proposition that the repose period is triggered by the misrepresentation, and cited *McCool v. Strata Oil Co.*, 972 F.2d 1452, 1460 (7th Cr. 1992) for the proposition that the cause of action accrues on the date the sale of the instrument is completed. 990 F.2d at 1136. Because both the misrepresentation *and* the purchase occurred more than three years prior to the filing of the complaint, the court found that the claim was not timely filed, without stating whether either "trigger," standing alone, would have been sufficient to warrant dismissal. *See id.*

In *Continental Bank*, 777 F. Supp at 102, the District Court commented on the timeliness of the plaintiff's Rule 10b-5 claims after first finding that those claims were mooted by decisions from other courts in related actions. Nevertheless, the *Continental Bank* court also found that the claims were barred by *Lampf*'s three year statute of repose. In doing so, it uttered the phrase upon which this Plaintiff's entire argument rests: that "[t]he repose period begins when the last alleged misrepresentation was made. . . ." *Id.* However, there is absolutely nothing—in either the text of the *Continental Bank* opinion or in the interpretation of it (*See* Pl's Resp., p. 4.)—suggesting that it was a case involving multiple repetitions or republications of the same *misrepresentation.*

Secondly, the Continental Bank court declined to rule that the trigger was the purchase or sale of the securities, believing that the "contention that the three-year period of repose begins anew at every purchase (and repurchase) of the [securities] defeats the purpose of the period's absolute outer limit." *Id.* For this Court to find that the period begins anew with each and every repetition of the same statement would achieve the same undesirable result.[15]

In sum, the Plaintiff cites to no authority for the proposition that the republication or reprinting of a previously printed statement is a "repeat" of the statement for Rule 10b-5 purposes. This is especially relevant when the initial statement is made in a document submitted to the SEC, and the "repeats" are also in

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[15] A statute of repose begins to run regardless of "discovery' of the violation, thus setting an outer limit within which a cause of action must be brought." *Hinkle v. Henderson*, 85 F.3d 298, 301 (7th Cir. 1996). Repose periods serve "two essential and related purposes: to prevent indefinite potential liability for a particular act or omission" and "to afford defendants . . . greater certainty in predicting potential liability." *Id.* at 302; *see also Caviness v. Derand Resources Corp*,. 983 F.2d 1295, 1300 n. 7 (4th Cir. 1993) ("A statute of repose 'runs from a fixed date readily determinable by the defendant,' thus serving the need for finality.")

documents filed with the SEC. As the Plaintiff states, the "fairest test" is one that would render the Defendant liable for "the last lie told." (Pl.'s Resp., p. 4.) Unfortunately for the Plaintiff, there was, at most, only one lie told here.

Second, and much more importantly, the Court finds no authority for the proposition that, even if it were true that Ernst repeated a printed statement (and for the purposes of a motion to dismiss, the Court treats this contention as true), each subsequent repetition would triggering an additional *Lampf* three year statute of repose.[16]

The Court therefore finds that, if a misrepresentation actionable under Rule 10b-5 was made, it was made on February 12, 1997. Any subsequent republication of that misrepresentation, even if made with Ernst's consent, does not act to trigger a new *Lampf* three year repose period. As the Plaintiffs complaint was filed well over three years after the alleged violation of Rule 10b-5, it is untimely and dismissal is proper.

B. Whether the Plaintiff's Complaint Demonstrates Scienter

Allegations of securities fraud must satisfy the pleading requirements of both Fed R Civ P 9(b) and the Private Securities Litigation Reform Act of 1995 ("PLSRA"). Rule 9(b) requires that complaints alleging fraud must state the circumstances constituting the fraud "with particularity" Fed. R. Civ. P. 9(b). The PLSRA[17] requires that in all private actions for money

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[16] That is not to say that there could be no set of circumstances where the reprinting or republication of a printed statement would trigger a new three year repose period. For example, the same result might not be warranted if the statements differed in some material way, or if the same statement was made to entirely different audiences (rather than to the SEC). On the facts of this case, neither of these considerations are implicated.

[17] Congress amended the Securities Act in 1995 through passage of the PSLRA, after concluding that "Rule 9(b) had not prevented abuse of the securities laws by private litigants." *In re Comshare*, 183 F.3d at 548 (internal quotation omitted).

damages based on the Securities Act [*sic*] which require "proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged . . . , state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[18] 15 U.S.C § 78u-4(b)(2).

In 1976, the United States Supreme Court held that "section 10(b) was addressed to practices that involve some element of scienter and cannot be read to impose liability for negligent conduct alone." *Ernst & Ernst v. Hochfelder*,[19] 425 U.S. 185, 200 (1976). While noting that "the term 'scienter' refers to a mental state involving intent," the *Hochfelder* Court declined to address "whether reckless behavior could give rise to Rule 10b-5 liability." *Id.* at 193 n.12.

This question has since been answered: recklessness does satisfy the 10b-5 scienter requirement in the Sixth Circuit. *See in re Comshare, Inc. Securities Litigation*, 183 F.3d 542 550 (6th Cir. 1999) (citing *Mansbach v. Prescott, Ball & Turben*,

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[18] Although the PSLRA requires Rule 10b-5 plaintiffs to allege facts giving rise to a strong inference of the required state of mind, it does not define what that required state of mind is. *See In re Comshare, Inc. Securities Litigation*, 183 F.3d 542, 549 (6th Cir 1999).

[19] In *Hochfelder*, Ernst & Ernst was the accounting firm retained by First Securities to perform audits of the firm's books and records. In connection with these audits Ernst & Ernst prepared First Securities' annual reports for filing with the SEC as required by § 17(a) of the 1934 Act. *Hochfelder*, 425 U S at 188. SEC Rule 17a-5 required that Ernst & Ernst provide a certificate stating "whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances." *Id.* at 188 n. 1. The plaintiffs filed a 10b-5 action against Ernst & Ernst. They alleged that the defendant's failure to utilize "appropriate auditing procedures" caused it to fail to discover that certain of First Securities' "internal practices" prevented an effective audit. *See id.* at 189-90. The plaintiffs did "'not accuse Ernst & Ernst of deliberate, intentional fraud, merely with 'inexcusable negligence.'" *Id.* at 190 n.5.

598 F.2d 1017, 1024 Cir. 1979)).[20] Thus, under the PSLRA, a plaintiff may survive a motion to dismiss by pleading facts that give rise to a strong inference that the Defendant either intentionally or recklessly committed fraud.

The Plaintiff asserts that its factual allegations, when viewed in their totality, are sufficient to support a strong inference of scienter. Plaintiff points to the presence of numerous "red flags," Ernst's failure to follow proper auditing procedures, GAAP violations, the magnitude of the fraud and motive and opportunity as evidence of the required state of mind.

The complaint is replete with references to what Fruit and "Fruit's top executives" knew and did. However, the allegations regarding what Ernst knew and what Ernst did are often speculative and conclusory, with no factual basis.[21] "A strong inference [of scienter] may not be drawn merely by asserting without elaboration that a particular defendant knew the very thing the plaintiff is trying to establish that the defendant knew." *Queen Uno Ltd. Partnership v. Coeur D'Alene Mines Corp.*, 2 F.Supp.2d 1345, 1361 (D. Colo. 1998). The basis for many of the allegations regarding Ernst is simply that it was in a position to know and learn certain things, therefore, it must have learned such things. Then, assuming that Ernst was aware of these certain things and knew their significance, the complaint concludes that Ernst's disregard of them was reckless. Conclu-

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[20] Recklessness falls somewhere between negligence and intent; it is "highly unreasonable conduct which is an extreme departure from the standards of ordinary care." *Comshare*, 183 F 3d at 550 (quoting *Mansbach*, 598 F.2d at 1024 n.6, 1025). It is "understood as a mental state apart from negligence and akin to conscious disregard." *Id.*

[21] For example, paragraph 41 of the complaint sets forth seven sets of adverse information that the Plaintiff claims were known only to Fruit insiders and Ernst. The Plaintiff's sole basis for this assertion regarding Ernst is that Ernst had "access to internal Fruit data." (Compl, para. 41; *see also* paras. 48, 72 (stating no basis for Ernst's "awareness" of certain information).)

sory allegations such as these are insufficient to plead a securities fraud claim.

In addition, the "'failure to follow GAAP, without more, does not establish scienter.'" *In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1426 (9th Cir. 1994) (quoting *Mione v. Microdyne Corp.*, 26 F.3d 471, 479 (4th Cir. 1994)); *see also Melder v. Morris*, 27F3d 1097, 1103 (5thCir 1994).

In an effort to establish motive, the Plaintiff claims that Ernst was motivated to commit fraud in order to retain Fruit as a client; to get Fruit's consulting business; to generate fees; and to increase its market share. (Pl's Resp., pp. 19-20; Compl, para. 90.) In *Melder v. Morris*, 27 F 3d 1097 (5th Cir. 1994), the plaintiffs' allegations aimed at establishing a motive for participating in the securities fraud were virtually identical to the plaintiffs "motive" allegations here. The *Melder* plaintiffs claimed that the accounting firm sought (1) to protect and enhance its fees; (2) to maintain and increase its market share; (3) to increase the income received by the partners responsible for the client; and (4) to maintain its competitive position with respect to other large accounting firms. *Id.* at 1103. The court—prior to the passage of the PSLRA—rejected the allegations as insufficient to establish scienter under Rule 9(b), finding that "[a] contrary conclusion would universally eliminate the state of mind requirement in securities fraud actions against accounting firms." *Id.* The court stated that "while the plaintiffs' motive allegations merely describe behavior which could be alleged against auditors generally, in this case, it seems extremely unlikely that [the firm] was willing to put its professional reputation on the line by conducting fraudulent auditing work."[22] *Id.*

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[22] This general reasoning had been used by the Seventh Circuit in *DiLeo v. Ernst & Young*, 901 F.2d 624 (7th Cir. 1990), which noted that:

> An accountant's greatest asset is its reputation for honesty, followed closely by its reputation for careful work. Fees for two years' audits

The complaint may sufficiently allege negligence on the part of the Defendant; however, when viewed as a whole, the Plaintiff's allegations of securities fraud are based on nothing more than speculation, guesswork and hindsight. The complaint fails to plead facts that give rise to a strong inference that the Defendant either intentionally or recklessly committed fraud, and thus does not comply with the pleading requirements set forth in the PSLRA. The Defendant's motion to dismiss is granted.

III. CONCLUSION AND ORDER

For the reasons set forth above, IT IS HEREBY ORDERED that

1. The Defendant's motion to dismiss the Plaintiff's complaint as barred by the one year statute of limitations is DENIED;

2. The Defendant's motion to dismiss the Plaintiff's complaint as barred by the three year statute of repose is GRANTED; and

3. The Defendant's motion to dismiss the Plaintiff's complaint for failure to plead the requisite scienter is GRANTED.

This the 15th day of December, 2000

Joseph H. McKinley, Jr.
Judge, United States District Court

[Entered December 20, 2000]

> could not approach the losses [the firm] would suffer from a perception that it would muffle a client's fraud . . . [The firm's] partners shared none of the gain from any fraud and were exposed to a large fraction of the loss. It would have been irrational for any of them to have joined cause with [the client].

Id. at 629

APPENDIX E

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY,
BOWLING GREEN DIVISION

CIVIL ACTION NO. 1:98-CV-99-M

NEW ENGLAND HEALTH CARE EMPLOYEES PENSION FUND,
on Behalf of Itself and All Others Similarly Situated,
Plaintiff,

v.

FRUIT OF THE LOOM, INC.; WILLIAM FARLEY;
BERNHARD HANSEN; RICHARD C. LAPPIN; G. WILLIAM
NEWTON; BURGESS D. RIDGE; LARRY K. SWITZER;
and JOHN WIGODSKY,
Defendants.

August 16, 1999, Decided
August 18, 1999, Entered

I. STATEMENT OF FACTS

This is one of two actions brought against Fruit of the Loom, Inc. ["Fruit"], its officers and/or directors, alleging improprieties and/or illegal activities. This action was brought by the New England Health Care Employees Pension Fund ["New England" or "the Fund"], on behalf of all those who bought common stock from July 24, 1996 through September 5, 1997. The Complaint alleges the following substantive counts: (1) violation of §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and of Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. §240.10b-5, for making false and fraudulent statements regarding Fruit's financial condition and engaging in insider trading, in operation of a fraud upon the Plaintiff shareholders; and (2)

violation of §20(a) of the 1934 Act, 15 U.S.C. §78t(a), alleging that C.E.O. William Farley had controlling authority over the other Defendants and Fruit generally, and thus should be held jointly and severally liable.

II. STANDARDS OF REVIEW

A. Elements of an Action Under § 10(b) and Rule 10b-5

To prevail in a claim for violation of §10(b) and Rule 10b-5, plaintiff must prove, in connection with a purchase or sale of securities, (1) a material misrepresentation or omission by the defendant; (2) scienter on the part of the defendant; (3) justifiable reliance by the plaintiff on the defendants' statements, or fraud on the market; and (4) damages that are causally related to the misrepresentation or omission. *E.g.*, *Hoffman v. Comshare, Inc.*, 27 F.3d 1142, 1999 WL 460917, at *4 (6th Cir. 1999); *Platsis v. E.F. Hutton & Co.*, 946 F.2d 38, 40 (6th Cir.1991), *cert. denied*, 503 U.S. 984, 118 L. Ed. 2d 389, 112 S. Ct. 1669 (1992); *Aschinger v. Columbus Showcase Co.*, 934 F.2d 1402, 1409 (6th Cir. 1991). Scienter has been defined as a "mental state embracing intent to deceive, manipulate or defraud." *Comshare*, 1999 WL 460917, at *4 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976)).

B. Elements of an Action Under § 20(a)

Section 20(a) of the 1934 act provides as follows: "Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a).

"A director of a corporation is not automatically liable as a controlling person. There must be some showing of actual participation in the corporation's operation or some influence before the consequences of control may be imposed." *Nichols v. Merrill Lynch*, 706 F. Supp. 1309, 1345 (M.D. Tenn. 1989) (quoting *Herm v. Stafford*, 663 F.2d 669 (6th Cir. 1981)).

> Control is the power, direct or indirect, to direct or cause the direction of the activities of the primary violator, whether by stock ownership, by contract, or otherwise. Under Section 20(a), control includes an indirect means of discipline or influence short of actual direction. Courts have focused on the power or potential power to influence and control the activities of a person, as opposed to the actual exercise thereof.

City of Painesville v. First Montauk Fin. Corp., 178 F.R.D. 180, 191 (N.D. Ohio 1998) (quotations, citations and footnotes omitted).

C. Standard Under Rule 12(b)(6)

The traditional analysis of a motion to dismiss, Fed. R. Civ. P. 12(b)(6), provides that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Comshare*, 1999 WL 460917, at *3 (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957)); *Mayer v. Mylod*, 988 F.2d 635, 637 (6th Cir. 1993) (same); *see Kentucky Laborers Dist. Council Health & Welfare Trust Fund v. Hill & Knowlton, Inc.*, 24 F. Supp. 2d 755, 757 (W.D. Ky. 1998). All factual allegations within the complaint are considered to be true. *Mylod*, 988 F.2d at 637. If an allegation is capable of several inferences, it must be construed in a light most favorable to the plaintiff. *Id.*; *In re DeLorean Motor Co.*, 991 F.2d 1236, 1240 (6th Cir. 1993).

D. Standard Under Rule 9(b)

When pleading fraud and certain other causes of action, the pleading standards are heightened by Fed. R. Civ. P. 9(b), such that all circumstances constituting the fraud "shall be stated with particularity." "The purpose of Rule 9(b) is to prevent the filing of a complaint as a pretext for the discovery of unknown wrongs," *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 752 (N.D. Cal. 1997). It also serves "to provide a defendant with fair notice of a plaintiff's claim, to safeguard a defendant's reputation from improvident charges of wrongdoing, and to protect a defendant against the institution of a strike suit." *City of Painesville v. First Montauk Fin. Corp.*, 178 F.R.D. at 187 (quoting *O'Brien v. National Property Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991)); *see In re Credit Acceptance Corp. Sec. Litig.*, 50 F. Supp. 2d 662, 1999 WL 349854, at *7 (E.D. Mich. 1999).

In general, a complaint sufficiently pleads fraud when it

> specifies the parties and the participants to the alleged fraud, the representations made, the nature in which the statements are alleged to be misleading or false, the time, place and content of the representations, the fraudulent scheme, the fraudulent intent of the defendants, reliance on the fraud, and the injury resulting from the fraud.

Michaels Building Co. v. Ameritrust Co., N.A., 848 F.2d 674, 679 (6th Cir. 1988). This type of requirement has been called the "who, what, when where and how" of the alleged fraud. *In re Grand Casinos, Inc. Sec. Litig.*, 988 F. Supp. 1273, 1281 (D. Minn. 1997).

In securities litigation specifically, however, a balance must be struck between two diametrically opposing interests. One is the public interest in deterring securities fraud and remedying it when it occurs. "Such interest is served by recognizing that the victims of fraud are often unable to detail

their allegations until they have had some opportunity to conduct discovery of those parties reasonably suspected of having perpetrated a fraud." *City of Painesville*, 178 F.R.D. at 187. To that end, it is in the public's best interest to "relax" the stringent pleading requirements, particularly "where the factual information is peculiarly within the defendant's knowledge or control." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1418 (3d Cir. 1997). This would allow actions to proceed where there is at least a facial validity to the allegations—*i.e.*, where the allegations are more than "boilerplate and conclusory," and where plaintiffs' legal theories are "accompanied [by] factual allegations that make their theoretically viable claim plausible." *Id.*

On the other hand, however, is the equally noble public interest in deterring litigation used "as a device for extracting undeserved settlements as the price of avoiding the extensive discovery costs" associated with a class action securities suit. *City of Painesville*, 178 F.R.D. at 187 (citing *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259 (2d Cir. 1993), *cert. denied*, 511 U.S. 1017 (1994)). "To allow plaintiffs and their attorneys to subject companies to wasteful litigation based on the detection of a few negligently made errors found subsequent to a drop in stock price would be contrary to the goals of Rule 9(b), which include the deterrence of frivolous litigation that could hurt the reputations of those being attacked." *In re Burlington Coat*, 114 F.3d at 1418.

E. The PSLRA

By the mid-1990s, class action securities suits against corporations whose stock value diminished had become commonplace. There arose a fear, as noted by some courts, *see In re Burlington Coat*, that the plaintiffs' bar was taking advantage of these actions, engaging in several "abusive practices." *See* H.R. Conf. Rep. No. 104-369 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 730-31. These included

filing actions "with only a faint hope" that discovery would lead to a "plausible cause of action"; filing suits against "deep pockets," without regard to culpability, when there was any significant decrease in stock price; filing class actions in the hope that the mere threat of broad discovery and lengthy litigation would convince many corporations to settle quickly; and "manipulation" of these actions by plaintiffs' lawyers, even where the merits were questionable, in an attempt to gain a substantial recovery for attorneys' fees. *Id.*

There was also a feeling that Rule 9(b) was not being interpreted by the federal courts in a manner which provided sufficient safeguards against corporations and their board members. Conf. Rep. at 740. Members of Congress felt that too many courts were taking the "remedying fraud" side of Rule 9 too far. The varied interpretations of Rule 9(b), in the conference managers' opinion, "had not prevented abuse of the securities laws by private litigants," and further had led to "conflicting [and] distinctly different standards" throughout the Circuit Courts of Appeal, particularly in the area of pleading the defendants' culpable state of mind, or "scienter." *Id.*[1] Others were concerned that class action plaintiffs' attorneys were violating Rule 11(b), which requires a certification that the action is not being brought for undue delay or harassment, and that a reasonable inquiry into the merits of the case had taken place. *Id.*; S. Rep. No. 104-98 (1995), reprinted in 1995 U.S.C.C.A.N. 679.

In response. Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA), to "establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits." S. Rep. at 679. The effort was to require much more specific factual support in complaints, so that mere allegations of wrongdoing could not

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[1] *See* discussion under "Scienter," infra.

go forward. Now codified at 15 U.S.C. § 78u-4, the PSLRA mandates that these actions be plead with greater specificity than other lawsuits:

> In any private action arising under this chapter in which the plaintiff alleges that the defendant—
>
> (A) made an untrue statement of a material fact; or
>
> (B) omitted to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

15 U.S.C. § 78u-4(b)(1). The statute also requires that the complaint "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." § 78u-4(b)(2). Plaintiff has the specific burden of proving "that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages." § 78u-4(b)(4).[2]

The Act requires the court to dismiss the action where "the requirements of [§ 78u-4(b)] (1) and (2) are not met." § 78u-4(b)(3)(A). When a motion to dismiss for failure to comply with the PSLRA is made, discovery is automatically stayed pending the ruling on that motion. § 78u-4(b)(3)(B).

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[2] The Act also requires the court to include "specific findings regarding compliance [with F.R.C.P. 11(b)] by each party and by each attorney representing any party." § 78u-4(c)(1). If any party or attorney is found to violate Rule 11, the act mandates sanctions (after a hearing), and presumes that attorneys' fees are the appropriate sanction (unless that presumption is rebutted). § 78u-4(d)(2),(3).

III. DISCUSSION

Defendants claim that New England's complaint suffers from this fatal lack of particularity, specifically in the allegations of fraud and scienter. There has been considerable debate among the parties, and indeed among federal courts nationwide, as to the precise standard which is to be used in judging whether a complaint meets the pleading requirements of the PSLRA. However, in this circuit at least, the issue has recently been made more clear with the Sixth Circuit's opinion of *Hoffman v. Comshare, Inc.*, 27 F.3d 1142, 1999 WL 460917 (6th Cir. 1999). But this opinion deals solely with the issue of scienter and proof under the PSLRA. A discussion of the parties' arguments with respect to general fraud under Rule 9(b) must be undertaken first.

A. Fraud

The standard for pleading fraud since the PSLRA has changed little from the Sixth Circuit cases interpreting Rule 9(b)'s specific allegation requirements. Though the appeals court has not specifically addressed the issue since passage of the PSLRA, at least two districts within the circuit have essentially reaffirmed the old standard in light of the Act. *See In re Credit Acceptance Corp. Sec. Litig.*, 50 F. Supp. 2d 662, 1999 WL 349854, at *7 (E.D. Mich. 1999) (citing the standard set forth in *Michaels Bldg. Co. v. Ameritrust Co.*, 848 F.2d 674, 679 (6th Cir. 1988)); *Havenick v. Network Express, Inc.*, 981 F. Supp. 480, 524 (E.D. Mich. 1997) (citing *Michaels Bldg.*). This standard requires the plaintiff to assert with specificity the "who, what, when, where and how" of the fraudulent scheme. *See In re Grand Casinos, Inc. Sec. Litig.*, 988 F. Supp. 1273, 1281 (D. Minn. 1997).

Defendants claim that the Complaint in this case fails to meet the above pleading requirements. They argue that Plaintiff's allegations are not factually based, but founded

only in "speculation." The Court disagrees with this contention. The Complaint outlines in considerable detail the purported fraud at issue. It notes with specificity Fruit's financial condition at the outset of the alleged scheme, the beginning of 1996 after an unprofitable 1995; the details of the proposed "restructuring," including the re-pricing of the board of directors' bonus incentive plans, public announcements regarding changes made to boost investor confidence, moving some operations offshore, and new inventory and management organization systems which would aid productivity; the questionable "success" and implementation of these changes, including the failure of the organization systems and the poor performance of offshore operations; Fruit's reported (successful) financial condition, in the form of public filings such as the Earnings Per Share reports, upon which the officers' incentive bonuses were based; Fruit's actual activities including questionable accounting procedures, employee layoffs, and plant closings; and finally the revelation of massive reported losses, which revealed that Fruit was not doing as well as anticipated or reported.[3] The who, what, where, when, and how of the fraudulent scheme have been set forth.

—*"Information and Belief"*

The Court also rejects Defendants' contention that P 166 of the Complaint is proof that Plaintiff's allegations are based upon nothing but "information and belief." While it is true that the PSLRA requires more than mere allegation based upon belief, *see In re Number Nine Visual Tech. Corp. Sec. Litig.*, 51 F. Supp. 2d 1, 1999 WL 362789, at *5 (D. Mass. 1999), the Complaint in this case adequately specifies "(1) the statements that the plaintiff contends were fraudulent, (2) the

[3] The Complaint is much more detailed than the Court could reasonably set forth within this opinion.

identity of the speaker,[4] (3) where and when the statements were made, and (4) why the statements were fraudulent." *Id.*; *Gupta v. Terra Nitrogen Corp.*, 10 F. Supp. 2d 879, 883 (N.D. Ohio 1998) (outlining same standard for Rule 9(b) fraud). Plaintiff alleges that specifically outlined public statements regarding Fruit's future, the purported status of the company, the expected returns and the status of the restructuring, made by the officers or by Fruit as an entity, were fraudulent because they were not true at the time they were made, based upon information either in the board's possession or reasonably within its knowledge. As mentioned above, this includes the failure of the overseas operations, the failure of the operations systems, and the increased inefficiency of the company as a result, the use of "pull-forward" or "channel stuffing" accounting methods to inflate fourth quarter earnings, and Fruit's loss of market share. The Complaint alleges that the company intentionally misrepresented the company's status to present and potential shareholders.

This is sufficient to satisfy the PSLRA's requirement to plead with specificity while still considering the fact that Rule 9(b) was designed not to prove a plaintiff's case, but to give notice to the defendants and ensure that the case is not being brought without any basis for the allegations. *See In re*

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[4] The Court rejects Defendant's argument that the PSLRA abolished the "group-pleading" doctrine. On the contrary, several courts have affirmed that the doctrine still exists even after the Act. *In re Digi Int'l, Inc. Sec. Litig.*, 6 F. Supp. 2d 1089, 1101 (D. Minn. 1998); Zuckerman v. Foxmeyer Health Corp., 4 F. Supp. 2d 618, 626 n.4 (N.D. Tex. 1998); *In re Stratosphere Corp. Sec. Litig.*, 1 F. Supp. 2d 1096, 1108 (D. Nev. 1998). Thus, even though some Defendants do not have allegedly fraudulent statements attributed to them, the fact that they were "controlling persons" (officers and directors), and allegedly acted in concert to disseminate the various disclosures, "the complaints need not draw a specific connection between these defendants and every alleged omission and representation." *In re Digi Int'l*, 6 F. Supp. 2d at 1101 (citation omitted).

Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1418 (3d Cir. 1997). To impose the incredibly high standard proposed by Defendants and implemented by some courts, *e.g.*, *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231 (N.D. Cal. 1998), would "make it extremely difficult to plead a 10b-5 claim—an outcome which would certainly be contrary to the broad remedial purpose of the federal securities laws." *Rehm v. Eagle Fin. Corp.*, 954 F. Supp. 1246, 1252 (N.D. Ill. 1997) (action after PSLRA); *see Press v. Chemical Invest. Sves. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999) (rejecting a more stringent standard for scienter). This is particularly true where, as here, much of the "smoking gun" evidence of fraud or misrepresentation, if there is any, would be nearly exclusively within the Defendants' control, in the form of internal memoranda, conversations among board members, and the like. *See Michaels Bldg. Co. v. Ameritrust Co.*, N.A., 848 F.2d at 680; *In re MobileMedia Sec. Litig.*, 28 F. Supp. 2d 901, 935 (D.N.J. 1998) (affirming this notion even in light of the PSLRA).[5]

—*Statements by Analysts*

Finally, Defendants contend that Plaintiff's allegations regarding analyst statements are not sufficiently pled. The allegation is that Defendants furthered their scheme to defraud the public by making false or misleading statements to analysts, who then made favorable market projections based upon that information. "[A] company may be liable under Rule 10b-5 for its own . . . misrepresentations to analysts that reach the market, whether or not the company adopts the resulting analysts reports." *In re Cirrus Logic Sec.*

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[5] In addition, as Plaintiff points out, the fact that the complaint is based upon an investigation of counsel, after review of public filings, discussions with analysts, etc., indicates that the Complaint is based upon much more than more "information and belief." Regardless, the Court concludes that Plaintiff states facts to support the "beliefs" set forth in the Complaint.

Litig., 946 F. Supp. 1446, 1467 (N.D. Cal. 1996); *Bryant v. Apple South, Inc.*, 25 F. Supp. 2d 1372, 1382-83 (M.D. Ga. 1998) (quoting *In re Cirrus Logic*).

Other cases refer to the "entanglement" test, in which the plaintiff must demonstrate that the defendants were somehow "entangled" with the analyst's information, such as by adopting it, or somehow "put their imprimatur, express or implied, on the projections." *See In re Boston Tech., Inc. Sec. Litig.*, 8 F. Supp. 2d 43, 55 (D. Mass. 1998); *In re Stratosphere Corp. Sec. Litig.*, 1 F. Supp. 2d 1096, 1115 (D. Nev. 1998) (citing among others *In re Syntex Corp. Sec. Litig.*, 95 F.3d 922, 934 (9th Cir. 1996)). These cases note that there must be more than a "one-way flow of information" for analyst fraud to attach. *E.g.*, *In re Stratosphere*, 1 F. Supp. 2d at 1115. However, this endorsement requirement is present only because "a company cannot be held liable for another party's interpretation of accurate information provided by the company unless the company adopts the third-party statement as its own." *In re Cirrus Logic*, 946 F. Supp. 1446. "No such two-way flow of information should be necessary, however, where the company deliberately or recklessly provides information to the analyst." *Id.*[6]

Though there are cases to the contrary, the Court finds the reasoning in *Cirrus Logic* to be persuasive. The general public should be protected against the misrepresentations of corporations and their members. If the misleading information is not based upon the analyst's interpretation of the information, but upon the corporation's wrongdoing, there is no justifiable reason to impose an additional pleading

[6] The Ninth Circuit has adopted In re Cirrus Logic and its holding regarding analyst statements. *See Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997) (noting that the prior decisions, including *In re Syntex*, requiring proof of entanglement "did not consider whether corporate defendants could be directly liable for misrepresentations to securities analysts") (citing *In re Cirrus Logic*).

requirement. The "entanglement" requirement merely allows corporations to shield themselves from potential liability by not adopting the analyst's statements. *See In re Cirrus Logic*, 946 F. Supp. at 1467 ("A company may not lie to securities analysts and avoid liability for its misrepresentations by refusing to adopt the analyst reports incorporating the misrepresentations.").

Moreover, the statements in question are identified by date, analyst, and detail the conversations with specific members of Fruit's board upon which they were published. The Complaint further alleges how and why the statements were false, by averring that other, less positive information of a specific nature was in the Defendants' possession. Included in this is the fact that the overseas operations were failing, that the management and information systems were not working properly, that Fruit used questionable accounting procedures to project earnings, and that strong competition had weakened demand for Fruit's products, which were contrary to assertions made by officers to the analysts. This is sufficient to overcome Rule 9 and the Act's requirements to plead fraud with particularity. *See In re Number Nine Visual Tech. Corp. Sec. Litig.*, 51 F. Supp. 2d 1, 1999 WL 362789, at *28 (D. Mass. 1999) (noting that Rule 9(b)'s particularity requirements apply to analyst's statements).

B. Scienter

In order to state a securities fraud claim, a Plaintiff must allege, in connection with the sale or purchase of securities, the misstatement or omission of a material fact, made with scienter. Scienter is a mental state embracing "intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976). As noted, the question of what constitutes scienter has been the subject of great debate. However, the question has been made more clear, at least in this circuit, by the opinion of

Hoffman v. Comshare, Inc., 27 F.3d 1142, 1999 WL 460917 (6th Cir. 1999). In this circuit, in order to sustain a claim under § 10(b), not only may the plaintiff plead facts giving rise to a strong inference that the defendant acted knowingly and intentionally, but a plaintiff may survive a motion to dismiss by pleading facts that give rise to a strong inference of "recklessness" ("understood as a mental state apart from negligence and akin to conscious disregard"). *Id.* at *7. In the *Comshare* decision, the court rejected the notion that scienter is satisfied by alleging facts demonstrating that the defendants had the "motive and opportunity" to commit the alleged wrongs. *See Shields v. Citytrust Bancorp., Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994). The court held as follows:

> Consequently, we cannot agree that under the PSLRA, plaintiffs may establish a "strong inference" of scienter merely by alleging facts demonstrating motive and opportunity where those facts do not simultaneously establish that the defendant acted recklessly or knowingly, or with the requisite state of mind. While facts regarding motive and opportunity may be "relevant to pleading circumstances from which a strong inference of fraudulent scienter may be inferred," *In re Baesa*, 969 F. Supp. [238, 242 (S.D.N.Y. 1997], and may, on occasion, rise to the level of creating a strong inference of recklessness or knowing conduct, the bare pleading of motive and opportunity does not, standing alone, constitute the pleading of a strong inference of scienter. Thus, under a plain interpretation of the PSLRA . . . , we hold that plaintiffs may meet PSLRA pleading requirements by alleging facts that give rise to a strong inference of reckless behavior but not by alleging facts that illustrate nothing more than a defendant's motive and opportunity to commit fraud.

Id. (footnote omitted).

—Application of Standard to the Present Case

The Court finds no merit to the contention that Plaintiff has failed to plead scienter. The Complaint is replete with specific allegations that Defendants acted with either affirmative intent to defraud, or at least with recklessness in carrying forth the scheme to inflate the stock price and/or to misrepresent the company's situation. There are allegations that Defendants know, or with reasonable diligence should have known, information which placed the company's financial status in a light directly opposite to that which is propounded in various press releases and statements to analysts. There are also assertions that the individual Defendants undertook these misrepresentations or false statements specifically in order to reap great personal gain, at the expense of the company.

The Court recognizes that the Comshare opinion dismisses the plaintiffs' complaint because it did nothing but present evidence of "motive and opportunity." 1999 WL 460917, at *9-10. However the Court finds that the present Complaint contains a much more detailed outline of the allegations and scheme of wrongdoing. Particularly relevant are the numerous positive statements by the individual Defendants, followed shortly by statistics and true reflections of the company's status which are at complete odds with the statements; the enormous amount of trading by insiders during a relatively short period of time; the company's large repurchasing scheme; and the use of questionable accounting tactics which suspiciously qualified the board of directors for enormous bonuses, even though the company's true production was not accurately reflected. These, while evidence of both motive and opportunity, "simultaneously establish that the defendant[s] acted recklessly or knowingly." *Comshare*, 1999 WL 460917, at *7.

The totality of the allegations give rise to a strong inference that the Defendants acted knowingly, or at least, in conscious disregard of the truth and their fiduciary duty. Therefore, the Court finds sufficient allegations of scienter to maintain an action under § 10(b) and Rule 10b-5. The motion to dismiss in this regard is denied.

C. Insider Trading

In their reply, Defendants assert that Plaintiff has failed to state a claim for insider trading, and that proof of insider trading is insufficient to give rise to an inference of scienter or a motivation for committing fraud. As to the first issue, Plaintiff does not need to affirmatively prove every element of the misconduct labeled "insider trading"—this is a case for fraud and misrepresentation under §10(b) and Rule 10b-5. Evidence of insider selling, however, can be used to demonstrate scienter and motive to commit fraud.

Though trading of stock by insiders cannot in itself create a strong inference of scienter, *see Wenger v. Lumisys Co.*, 2 F. Supp. 2d 1231, 1251 (N.D. Cal. 1998), such an inference can be made where the trades are "suspicious" or "unusual." *See In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1117 (9th Cir. 1989) ("Insider trading in suspicious amounts or at suspicious times is probative of bad faith and scienter."), *cert. denied*, 496 U.S. 943 (1990); *In re Miller Indus., Inc. Sec. Litig.*, 12 F. Supp. 2d 1323, 1332 (N.D. Ga. 1998) ("Unusual insider trading during the class period may support a strong inference of scienter."). "Unusual" or "suspicious" trading may be determined by examining past trading practices, focusing particularly on the amounts or percentages of the defendants' total shares sold during the period. *See Marksman Partners v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1312-13 (C.D. Cal. 1996).

In this case, there are allegations that the individual Defendants sold enormous amounts of their personal stock—most

totaling 80-100% of the individual's shareholdings—during a 15-month period, where no significant stock sales had been made in the previous three years. Further, the vast majority of these sales occurred just prior to the company's formal announcements that its financial condition was not what the company had anticipated it to be. Add these facts to the (particularly pled) allegations that the Defendants fraudulently inflated the stock price and fraudulently inflated earnings reports in order to individually profit from the transactions, and the totality of the circumstances certainly does give rise to a strong inference of scienter.[7]

D. Loss Causation

There are two types of causation in securities fraud actions—transaction causation and loss causation. *See Robbins v. Koger Properties, Inc.*, 116 F.3d 1441, 1447 (11th Cir. 1997); *EP MedSystems, Inc. v. Echocath, Inc.*, 30 F. Supp. 2d 726, 769 (D.N.J. 1998). Transaction causation is similar to a "but for" test—but for the defendants' omissions or misrepresentations, the shareholder would not have either bought or sold the stock during the period in question. *See EP MedSystems*, 30 F. Supp. 2d at 770 (citations omitted). Transaction causation is "another way of describing reliance." *Robbins*, 116 F.3d at 1447 (citations omitted). The Complaint adequately pleads this type of causation by its statement that the members of the class "would not have purchased Fruit stock or options at the prices they paid, or at all, if they had been aware that the market prices had been artificially inflated by defendants' misleading statements."

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[7] Defendant's position that because the board members disclosed the fact that their executive compensation plans included stock transactions is entirely irrelevant to the question of whether insider selling creates a strong inference of scienter.

At issue, however, is loss causation, which is akin to "proximate causation." *See Robbins*, 116 F.3d at 1447. It is "a causal link between the alleged misrepresentation and the harm incurred when a security is purchased and sold." *EP MedSystems*, 30 F. Supp. 2d at 770 (quoting *Angelastro v. Prudential-Bache Sec., Inc.*, 764 F.2d 939, 944 (3d Cir.), *cert. denied*, 474 U.S. 935 (1985)). Loss causation is "economic in nature, id., and "looks to whether the misrepresentation caused the plaintiff's pecuniary injury," *Edward J. DeBartolo Corp. v. Coopers & Lybrand*, 928 F. Supp. 557, 562 (W.D. Pa. 1996). Thus, rather than ask whether the misrepresentation caused the plaintiff to enter into the transaction, the inquiry is whether the fraud caused the stock price to modify. *See Gannon v. Continental Ins. Co.*, 920 F. Supp. 566, 580 (D.N.J. 1996).

Defendants argue that because the price of the stock in question went up during the period of the alleged fraud, there can be no proof of loss causation. While this is typically the case in discussing loss causation, the shareholder Plaintiffs in this case have alleged an economic loss—the "artificially inflated" price of the stock they purchased because of the alleged false statements and misrepresentations. *See Scattergood v. Perelman*, 945 F.2d 618, 624 (3d Cir. 1991). The *Scattergood* court notes that plaintiffs only need to allege that "the market price paid by plaintiffs exceeded the value of the stock at the time of purchased based on the true facts." *Id.* This is precisely what the Complaint alleges.

Defendants' assertion that Plaintiff must allege "which failure to disclose which Adverse Information caused which stock price drops, and when," Dft. br. [DN 18], at 17, is simply not the law. All that is required is that Plaintiff allege a causal relationship between the misrepresentations or false statements and the value of the stock, which it has done.

E. Section 20(a)

The only argument in support of dismissing the § 20(a) claim is that it is derivative of the § 10(b) claim. *See* Dft. br. [DN 18], at 21 n. 16. Thus, because the Court declines to dismiss the § 10(b) claim, the claim under § 20(a) will be retained.

For the foregoing reasons, IT IS HEREBY ORDERED that Defendants' Motion to Dismiss the action [DN 18] is denied.

This the 16th day of August, 1999.

JOSEPH H. MCKINLEY, JR.
Judge, United States District Court

APPENDIX F

No. 90-333

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

LAMPF PLEVA LIPKIND PRUPIS & PETIGROW,
Petitioner

v.

JOHN GILBERTSON, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS *AMICUS CURIAE*
[EXCERPTS]

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QUESTION PRESENTED

Whether the statute of limitations for implied private actions under the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, should be drawn from state law or from an express limitations period found in the federal securities laws.

* * *

[pp. 21-23]

[§D.1.] b. Quite apart from the fact that engrafting the one-and-three-year periods onto Section 10(b) is inconsistent with those aspects of *Hochfelder* and *Huddleston*, it is also crucial to note that there is no single "one-and-three-year" period in the securities laws; rather, there are only multiple variations on a theme, each uniquely fashioned for a particular express right of action. *See* L. Loss, *supra*, at 988-991.

Section 9(e) of the 1934 Act provides a period of one year after "discovery of the facts constituting the violation," but no more than three years after "such violation," 15 U.S.C. 78i(e). Section 18(c), in contrast, starts the one-year period after discovery of facts constituting "the cause of action," and bars suits three years after the cause of action "accrued." 15 U.S.C. 78r(c). And, Section 29(b)'s one-and-three-year periods are tied to the date of the "sale or purchase" involving the violation. 15 U.S.C. 78cc(b). These variations in language can produce strikingly different results when applied to the same set of facts.[30] Section 13 of the 1933 Act, in turn, provides still other

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[30] The date of a Rule 10b-5 "violation" need not coincide with the "accrual" of a cause of action. In *Basic Inc. v. Levinson*, for example, the Rule 10b-5 violation was a company's issuance of false or misleading public statements denying it was engaged in merger talks. A class action was brought on behalf of shareholders who sold their stock in the company between October 1977 (the time of the first false statement) and December 1978 (when a merger was announced). 485 U.S. at 227-228. The "violation"

variations for each of its express rights of action. 15 U.S.C. 77m. In particular, claims under Sections 11 and 12(2)—unlike claims under Sections 9, 18, and 29 of the 1934 Act—must be filed within one year of actual or constructive discovery ("after such discovery should have been made by the exercise of reasonable diligence").[31] The three-year outside periods also begin to run from different events—after the security was "bona fide offered" for Section 11, but after the "sale" for Section 12(2).[32]

Although these variations can make a critical difference for the timeliness of any particular action, the courts of appeals that have embraced the one-and-three-year periods appear not to have appreciated the quandary. The Third Circuit, leading the way in *Data Access*, purported to apply the general one-and-three-year "schema" in the Exchange Act, 843 F.2d at 1546, but ultimately adopted a limitations period of "one year after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation", *id.* at 1550, a formulation that corresponds to Section 9(e) of the 1934 Act.[33]

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occurred when false statements were made; the cause of action could not have "accrued" until each shareholder actually sold his stock. The results of applying the limitations periods of Sections 9(e) and 18(c) would therefore diverge. In contrast, Section 20A (b) (4)'s test ("date of the last transaction that is the subject of the violation") would provide far greater certainty and ease of application.

[31] A Section 12(1) claim must be brought within one year "after the violation upon which it is based," but no more than three years "after the security was bona fide offered to the public".

[32] The 1933 Act limitations periods were originally two years and ten years, Act of May 27, 1933, ch. 38, §13, 48 Stat 84, but Congress shortened those periods when it amended the Securities Act in 1934. 48 Stat 908. *See Ernst & Ernst v. Hochfelder*, 425 U.S. at 210.

[33] The court did not explain why it chose the Section 9 formulation. If the theory behind borrowing the one-and-three-year periods is that Section 10(b) and Rule 10b-5 are analogous to the *cumulative* scope of Sections 9, 18, and 29 of the 1934 Act, and Sections 11 and 12 of the 1933 Act, it is inconsistent

The Seventh Circuit, following on the heels of *Data Access*, mistakenly thought that the Third Circuit had selected Section 13 of the 1933 Act; it then concluded that Section 12(2) formed the appropriate model for Rule 10b-5, and ultimately adopted Section 12(2)'s one-and-three-year limitations provision. *Short*, 908 F.2d at 1390-1391. But that provision includes a *constructive* discovery limitation on the one-year period, in conflict with the choice made by *Data Access*.[34] Finally, the Second Circuit held that Rule 10b-5 claims would be governed by "the statute of limitations provided in the 1934 Act for express rights of action under §§9(e) and 18(a) of that Act," *Ceres Partners*, slip op. 7274, even though the language of those two provisions differs. The three-way conflict generated by the courts of appeals underscores the futility of searching for an apt analogy in any of the express rights of action enacted in 1933 and 1934 for purposes of selecting the appropriate statute of limitations for Rule 10b-5.

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with that rationale to conclude that the Section 9 limitations period in particular should be applied to *all* Section 10(b) claims.

[34] In the Third Circuit, the one-year period is not subject to a constructive discovery limitation. *See Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n. 4 (1990).